ACCESS TO CAPITAL: CAN SMALL BUSINESSES ACCESS THE CREDIT NECESSARY TO GROW AND CREATE JOBS?

HEARING

BEFORE THE

COMMITTEE ON SMALL BUSINESS
UNITED STATES
HOUSE OF REPRESENTATIVES

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HOUSE COMMITTEE ON SMALL BUSINESS

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HEARING: ACCESS TO CAPITAL: CAN SMALL BUSINESSES ACCESS THE CREDIT NECESSARY TO GROW AND CREATE JOBS?

WEDNESDAY, JUNE 1, 2011

HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
Washington, DC.

The Committee met, pursuant to call, at 1:00 p.m., in Room 2360, Rayburn House Office Building. Hon. Sam Graves (chairman of the Committee) presiding.

Present: Representatives Graves, Bartlett, Herrera Beutler, Coffman, Mulvaney, Ellmers, Landry, West, Tipton, Velázquez, Chu, Cicilline, Peters, Owens, Altmire, Clarke.

Chairman GRAVES. I call this hearing to order. I want to thank all of our witnesses for being here today. We look forward to hearing your testimony. I apologize for being a little bit late as we had a vote called.

As America works to recover from this recession, which has obviously been a terrible blow to a lot of folks, we are going to be relying on the nation's small businesses to help lead the way.

For small businesses to expand and create jobs, they need adequate financing. However, small businesses are telling us that access to capital remains a hurdle in the current economy, despite rallies on Wall Street and government efforts to loosen credit. On the other side of the equation lenders say that they have capital available but businesses are not as credit worthy as they were just a few years ago. Banks claim that today's borrowers have lower credit scores and lower collateral value due to the depressed real estate values. If we want our nation's entrepreneurs to grow their businesses and create jobs, we need to bridge the gap between lenders and small business borrowers.

We have called this hearing today to examine the challenges that both small businesses and banks are facing when deciding to expand or to lend money. In addition, we are going to examine alternative kinds of financing for small businesses and other avenues available for businesses to get the capital that they need.

Again, I am very pleased to have several distinguished witnesses here today to provide members of this committee with insight about the importance of capital for small businesses and the impediments leading to the bank or leading to lending that banks are experiencing today. I think this is going to be a very good hearing. It is a very timely hearing, obviously. And with that, I am going to yield to the ranking member for her opening statement and then we will get started.

Ms. VELÁZQUEZ. Thank you, Mr. Chairman.

Job creation is understandably a top priority for all Americans right now. New data out just this morning suggests the economy added only 38,000 jobs in the month of May. This new number shows large firms cut their workforces this month. We could clearly use some of the small businesses' job creating power right now.

In order for small firms to play their traditional job creating role, several factors must be in place. Perhaps the most important ingredient is the availability of capital. If small businesses are truly the backbone of the economy, then the flow of capital is the lifeline. Although challenges remain, there has been progress in this area. Small business loan approvals in the first quarter of this fiscal year are up 15 percent over last year. Fewer small firms are falling behind or defaulting on loans, suggesting they are in better shape to take on additional debt and hopefully expand.

Lending through the Small Business Administration is always critical for entrepreneurs seeking affordable capital. However, during economic downswings when credit is tied elsewhere, the SBA's role becomes more important.

Several provisions this Committee crafted in the Recovery Act temporarily boosted SBA-backed lending. Raising guarantees on this, SBA 7(a) loans gave banks greater incentive to make small business loans. Other provisions made the loans more affordable for borrowers. As of now, those steps have demonstrated the most quantifiable proven results. Other recent policy actions have yet to exhibit the same level of success.

Examining the amount of SBA lending is only one metric. For these loans to ignite real job growth, the agency must concentrate on the right kind of small businesses, namely start-ups with the highest potential for job creation. On average, it costs nearly $75,000 to launch a new enterprise, a tough proposition under even the best circumstances. Unfortunately, these small start-ups are not seeing their fair share of SBA loans. During the first half of fiscal year 2011, less than one-quarter of SBA loans' dollars went to start-ups.

It is my hope that today's discussion will generate new ideas about how Congress, the SBA, and the lending community can expand all small firms' financing options, but especially for those at the earliest stage of the business cycle. As the Committee moves forward, we should examine the full spectrum of capital options for small firms. Some businesses will do fine through conventional loans, while other entrepreneurs can meet their capital needs with microfinancing. For start-ups, a debt bay solution may not make sense at all. Investment capital might be a better fit. What works for a small manufacturer in Ohio, may not be appropriate for a family farm in Tennessee, to say nothing of a technology start-up in lower Manhattan.

On that note, I would like to thank our witnesses for taking time out of your busy schedule to be here with us. Their diverse views and experiences will be valuable to the Committee as we consider how best to meet entrepreneurs' capital options and needs.

I yield back, Mr. Chairman.

Chairman GRAVES. Thank you, ranking member.

If any other Committee member has an opening statement, I would ask that you submit it for the record.

I would like to explain the lights to you real quick. Each of you have five minutes and the lights will be green. When you get down to a minute it will turn yellow and then it will go red. We will be a little lenient on that but please try to stay within the five-minute mark.

STATEMENTS OF WILLIAM HALL, CEO, WILLIAM G. HALL & CO., ON BEHALF OF THE INTERNATIONAL FRANCHISE ASSOCIATION; LYNN OZER, EXECUTIVE VICE PRESIDENT, SUSQUEHANNA BANK, ON BEHALF OF THE NATIONAL ASSOCIATION OF GOVERNMENT GUARANTEED LENDERS; DENNIS JACOBE, CHIEF ECONOMIST, GALLUP; ROBERT KOTTLER, EXECUTIVE VICE PRESIDENT, DIRECTOR OF RETAIL AND SMALL BUSINESS BANKING, IBERIABANK, TESTIFYING ON BEHALF OF THE CONSUMER BANKERS ASSOCIATION

Chairman GRAVES. Our first witness today is William Hall, who is the chief executive officer at William G. Hall and Company. Mr. Hall is a Dairy Queen franchisee with five locations in Texas. Mr. Hall also serves on the board of directors for the International Franchise Association and chairs their Credit Access Committee. We appreciate you being here today. Obviously, you came a long way, and I look forward to your testimony.

STATEMENT OF WILLIAM HALL

Mr. HALL. Thank you, Chairman Graves. And I want to thank you, as well as Ranking Member Velázquez and the rest of the Committee. Thanks for having me here. Five minutes, it is hard for me to say hello but I am going to do my best here.

As you said, I am a Dairy Queen franchisee in Fort Worth, Texas, and I am a member of the International Franchise Association Board of Directors.

I want to talk about the important role in the U.S. economy franchising holds. As Ms. Velázquez mentioned, small business startups are an important part of our economy and franchising meets that need but with a little bit of a lifeline for the first people and first role in the business because they do have a system of training and it allows someone to start a business without being in business totally by themselves.

The franchising world grew at a faster pace than the non-franchising world up to 2008 when we had the financial meltdown. Since then recovery has been very slow, markets have been frozen, very difficult to obtain any sort of financing. We greatly appreciate the work you guys did on the Small Business Jobs Act. Those SBA provisions have been a lifeline for franchising. It is something that we really do appreciate. But currently, other than SBA, there is very little lending out there for the entrepreneurs in the franchising world.

To survive, the franchising community—we cut back. We lived with what we had. We did not add new jobs. We did not remodel where we needed to because we were caught in a situation where we just could not borrow any money. And that was pretty much across the board. That is small to large. It impacts all sectors. We delayed the new store acquisitions. Franchise wars were not a problem because they could not put new people into their units because they could not get the initial financing. People would pay the franchise fee but they could not get the initial financing to get going.

We think that small business creates six out of 10 jobs in the country, and if we do not have access to credit then we are not creating the jobs that we need. We think there is a 20 percent shortfall in lending to franchise this year and the SBA has been critical in filling the need but we are still going to be 20 percent short. And that means there are a lot of jobs not going to be created that could be if we had normal access to credit.

Franchising is all about small business. Franchising sometimes gets confused because people talk about McDonald's, even Dairy Queen as being large companies. I started from nothing, had nothing, and most of the people I know in the franchising business started with one unit and grew from that. We are resilient as a group. We are diverse as a group. In the franchising industry, 19 percent of the franchises are owned by minorities whereas in the nonfranchise sector there is 13 percent owned by minorities. So we have a great program for veterans that come back home. Over 400 franchisors have put in a program to give a discounted start-up opportunity for veterans. We feel like that has been a fantastic program and well received and a great opportunity for our veterans coming back.

As I said, in the franchising world, you are in business for yourself but not by yourself. And that is a tremendous benefit, which does, in fact, put us into a position where we could be a good borrower for these lenders that want to make loans, which they need to make loans to be successful. So we thought how could we solve this problem without any other help from anyone? And we decided as a group to get together from the franchising world and reach out to the lenders to try to show them what we had to offer because we knew they needed to make loans.

So as a franchise loan, we think it is a better loan than a nonfranchise loan because you do have the system in place. There is training. There is support. The franchisor does underwriting before you go to the lender so there is some safety there.

So what we did is put together a credit summit to bring together all the parties. I do not want to take the Committee's time to go through it and I do not have the time, but I would ask the chairman if we could perhaps introduce this piece into the record which does describe the credit conference we had and brought together lenders and franchise folks to try to come up with a solution, a private sector solution to the problem.

As we go forward, we need help in this regard. We need to help our lender friends to be able to loan money to us. We are going to do our part. We are good loans. We are not trying to look for a bad loan. We are trying to put a proven loan that can be made and paid back. But we do need help because those markets are closed to us right now.

Without the SBA lending right now, we would be a lot less people employed in the U.S. And with their help and your help to them, I know there will be a lot more jobs available. We are not looking for a bailout. We just need access to credit so we can grow our businesses and to provide more jobs.

And I want to thank everyone for having us here. I will be happy to answer any questions. Thank you.

[The statement of Mr. Hall follows:]

IFA INTERNATIONAL FRANCHISE ASSOCIATION | Franchising Building local businesses, one opportunity at a time.

Statement of William G. Hall, CFE
Chief Executive Officer
William G. Hall & Company

Before the House Committee on Small Business

Hearing on *Access to Capital: Can Small Businesses Access the Credit Necessary to Grow and Create Jobs?*

June 1, 2011

1501 K Street, N.W. Suite 350 Washington, DC 20005
Telephone: 202/628-8000 Fax: 202/628-0812 E-Mail: ifa@franchise.org Internet: www.franchise.org

Statement of
William G. Hall
CEO, William G. Hall & Company
United States House of Representatives
Committee on Small Business

June 1, 2011

Good afternoon Chairman Graves, Ranking Member Velázquez and members of the committee. My name is Bill Hall. I am the CEO of William G. Hall & Company and I am also a franchisee of International Dairy Queen, currently operating five locations in Texas. I am grateful to have the opportunity to speak to you today about the credit challenges facing small business entrepreneurs and the efforts of leaders in the private sector to address these challenges.

In addition to my experience as a small franchise business owner, I have owned and operated community banks, independent restaurant concepts, a nationwide transportation company, financial services companies and real estate investments. Currently, I serve on the Board of Directors of the International Franchise Association (IFA), as well as chair the IFA's Credit Access Committee.

As the largest and oldest franchising trade group, the IFA's mission is to safeguard the business environment for franchising worldwide. IFA represents more than 11,000 franchisee, 1,100 franchisor and 575 supplier members nationwide. According to a recent study conducted for the IFA Educational Foundation, there are over 825,000 franchise businesses across 300 business lines providing nearly 18 million American jobs and generating over $2.1 trillion to the U.S. economy.

Franchised businesses play an important role in the overall health of the U.S. economy, and in past years they have led the economy out of recession and into recovery and growth. Franchising grew at a faster pace than many other sectors of the economy from 2001 to 2005, expanding by more than 18 percent. During this time, franchise business output increased 40 percent compared to 26 percent for all businesses.

But this recovery, following the worst Recession since the Great Depression, is different. Unemployment rates remain high long after the recession technically ended. Credit markets froze in 2008 and have not bounced back. In 2009, members of the IFA testified before this Committee and you supported legislation that would help increase the flow of loans to small businesses through the Jobs Act via loan guarantees and waivers for borrowing fees in the SBA loan programs.

The Small Business Jobs Act (P.L. 111-240), and especially the SBA provisions were a lifeline to franchise small businesses by providing credit where none existed in the market. But while that legislation was a good start, serious challenges remain. There is very little credit flowing to small businesses except for SBA loans, which are an important but still limited part of the market.

Small businesses that survived the recession, as you know, did so by squeezing every efficiency they could from their operations. Employees became more productive and worked longer and harder. Nonessential employees were cut. Investments and upgrades were delayed.

The small businesses that create 6 out of every 10 jobs in America – they can't squeeze any more blood out of the stone. They need to borrow to keep up with the competition. Yet, commercial credit, as FDIC Vice Chairman Martin Gruenberg told some of this Committee's staff at the IFA's recent Small Business Lending Summit, is not flowing to small businesses.

What does this mean? For our industry, the continued lack of available commercial credit is putting a chokehold on our ability to expand to meet demand and create the jobs our country so urgently needs.

A study commissioned by the IFA showed that franchise businesses will require $10.4 billion in new lending capital to fulfill 100 percent of the forecasted demand for new and transfer units in 2011, but credit flow may fall short by 20% or more.

Under normal circumstances, small businesses could tap financing from a number of different sources, including national and community banks as well as many non-bank lenders. But due to increased capital reserve requirements, heightened regulatory scrutiny of commercial banks, depressed home equity values and other traditional forms of collateral, and generally increased aversion to risk, commercial credit is not flowing. The SBA, previously a small portion of the credit market, has become the lender of first resort. In some cases, it is the lender of **only** resort.

A recent Wall Street Journal report estimated that every time the average franchise opens, it creates 10 jobs directly and 20 jobs in the economy. If franchisees could borrow all the money they need this year, they could purchase over 41,000 new or transfer businesses and create an astounding 333,000 new jobs.

We are grateful for the Small Business Jobs Act, which we strongly supported. We are grateful for the leadership the Small Business Committee provided in highlighting the importance of the SBA loan programs. The new law permanently increased the maximum loan guarantee limits from $2 million to $5 million. As a result of the enhanced loan guarantees, waived fees and new maximum limits, the SBA witnessed historic loan volumes in the final quarter of 2010. The enhanced programs allowed the SBA to leverage over $500 million in taxpayer dollars into just under $12 billion in new loans to small businesses. While that is welcome news, we are nowhere near where we should be given the demand needed in franchising.

More engagement by Congress, the administration and financial regulators is needed. Congress should examine capital reserve requirements and regulatory scrutiny by the FDIC, the Fed and the OCC that may be unintentionally, unnecessarily and harmfully holding back credit access by small businesses.

Congress should examine how SBA loan guarantees are considered by financial regulators. If regulators are not giving due consideration of SBA loan guarantees when capital reserves are calculated, this pressure can discourage or event prevent banks from lending to small business despite Congress's intent to expand credit access. We urge the committee to examine these critical issues, up to and including hearings on financial regulation and small business credit flow.

Meanwhile, the IFA has launched a Nationwide Credit Access Campaign to strengthen borrower and lender education, increase awareness of this issue, and promote pro-lending, pro-business policies to support the small businesses that create the majority of our nation's jobs. As you may know, IFA organized and hosted a Small Business Lending Summit in conjunction with the National Association of Government Guaranteed Lenders (NAGGL), the Consumer Bankers Association (CBA), CIT Group and the National Restaurant Association (NRA). Nearly 200 leaders of the financial, franchising and policy communities gathered to begin a dialogue to address this critical issues.

But our work has just begun.

Our Credit Access Roadshow will be taking our message to lending groups and franchising events across the country, including June's meeting of the U.S. Conference of Mayors in Baltimore and CBA's upcoming annual meeting in Orlando.

Our coalition is scheduled to meet with the FDIC to discuss some of the hurdles small businesses and lenders face. We will also support "Discovery Days" to assist lenders in learning more about franchising and scrutiny that goes into vetting franchisees before they seek financing. Our campaign partners will develop webinars to assist emerging franchisors and prospective franchisees to be better prepared when they walk through the doors of their local bank.

As you can see, the private sector has taken advantage of the enhanced tools Congress granted the SBA in the Small Business Jobs Act. But we need the engagement of our Congressional leaders to advocate for policies that will improve this situation. The IFA looks forward to working with this Committee throughout the legislative session to ensure SBA's programs are adequately funded and working efficiently. We also stand ready to support Congress in its efforts to reduce or streamline the regulatory burdens facing small businesses and especially those that restrict access to capital. Working together, in our view, is critical to the recovery of small businesses and our economy. So we thank you for this opportunity.

I look forward to answering any questions you may have.

Chairman GRAVES. Thank you, Mr. Hall.

Our next witness I would like to introduce is Lynn Ozer. Ms. Ozer is the executive vice president of small business and SBA lending at Susquehanna Bank located in Pottstown, Pennsylvania. Ms. Ozer is representing the National Association of Government Guaranteed Lenders where she has served on the board of directors since 1988. Thanks for coming and I look forward to hearing what you have to say.

STATEMENT OF LYNN OZER

Ms. OZER. Thank you, Chairman Graves, Ranking Minority Member Velázquez, and all the members of the Committee.

As Chairman Graves mentioned, I am the executive vice president of Susquehanna Bank where I manage SBA and all government guaranteed lending throughout our banks for state footprint. Susquehanna Bank is a Pennsylvania state chartered bank with approximately $14 billion in assets and operates throughout 223 branches in the mid-Atlantic states. Susquehanna is active in both SBA 7(a) and 504 programs, currently holds a portfolio of approximately $300 million in government guaranteed loans.

I am also here representing more than 700 members of the National Association of Government Guaranteed Lenders (NAGGL). For the past 23 years, I have served on their board of directors, and for many of those years I have served on their executive committee and as chair of the Technical Issues Committee. NAGGL's lender members are responsible for approximately 80 percent of the annual 7(a) volume, as well as most of the lender portions of the SBA 504 loans.

Thank you for inviting me to testify and for holding this hearing on the important issue of small businesses availability—ability to access capital. In the interest of time, I will submit my full written testimony for the record and provide just a brief summary.

I want to begin by publicly thanking the International Franchise Association (IFA) for taking a leading role, driving the discussion on the direct correlation between access to credit, job creation, and economic development. Because of the exemplary efforts, both NAGGL and IFA today, we have a 7(a) loan program that is much better able to meet the capital needs of America's small business.

And it is important to note that the IFA work on this issue did not end with the passage of the Small Business Jobs Act. Approximately a year ago, while we were working on credit access issue on different tracts, NAGGL and IFA began a dialogue that we have continued. Through those encounters we came to realize that there is a significant overlap in the issues affecting both organizations' memberships and to note that each group has much to learn from each other. So IFA and NAGGL have forged a partnership intended to increase the availability of capital to franchise small businesses.

A highlight of IFA's ongoing efforts to address the credit issue was the credit summit that IFA organized and delivered in April. Bill Hall, chair of IFA's Credit Committee, has briefly described some of the things that IFA is doing, but because neither he nor IFA will tout the organization's work to bring attention to this important issue and IFA's continuing commitment to this effort, I want to do that for him and them.

I also want to specifically mention the exemplary leadership shown by IFA's CEO, Steve Caldeira, who has worked tirelessly to highlight the important role that access to credit plays in creating jobs and increasing economic output. The most important message that I can bring to the Committee today is to reiterate what you already know. SBA loans are critical to keeping the small business segment of the economy, the biggest job creating segment, healthy.

We are seeing signs of economic recovery, but for a variety of reasons accessing capital continues to be difficult for small businesses. Lenders want to be able to provide this necessary capital, but they are experiencing a perfect storm of circumstances that together serve to stifle the conventional small business lending activities.

So how are banks meeting the credit needs of their small business customers? Many lenders are increasingly turning to SBA loan programs, and in particular to the SBA 7(a) Loan Program.

Having a healthy 7(a) program is essential to keeping credit flowing because SBA is the single largest provider of long-term capital to U.S. small businesses. Its loan guaranteed account for well over 40 percent of all long-term small business loans made in America. From the lenders' viewpoint, a key benefit to the 7(a) program is that it takes less capital to support an SBA loan than it does a conventional loan. From the small business viewpoint, the SBA guarantee allows increased access to capital, particularly to the kind of financing that appropriately matches the loan term to the life of the loan assets being financed. That is, finances long-term assets with long-term loans.

According to the federal statistics, a typical 7(a) loan has an average original maturity of 12 years, while conventional small business loans typically have an original maturity of three years or less with a significant majority of those loans having maturities of one year or less. Longer maturities allow small businesses to access capital that would not be available to them if repayment were required in substantially shorter periods. The importance of SBA lending to small business clearly demonstrates by recent demand for the program.

According to SBA, in the last two years the 7(a) and 504 guarantees enable private sector lenders to provide approximately $42 billion in loans to small business. However, the success of the 7(a) program this year is causing a new problem. Based on the loan approvals to date, it appears highly likely that the program demand will exceed the $17.5 billion program level ceiling set by congressional appropriators. This means that it is likely that the 7(a) program will have to shut down sometime late this summer unless the Congress acts to raise the program level. In order to avert this potential program suspension, NAGGL, on behalf of its members, is requesting that Congress act now to increase this year's program level for SBA's business loan programs to $19 billion. This increase will not affect the budget because sufficient appropriations are already available to support the increase to the program level ceiling.

We know small businesses lead the way to creating new jobs, and we know that having a vibrant small business segment in our economy is vital to continuing the fragile economic recovery that we are seeing. We also know that keeping SBA's 7(a) and 504 loan programs available to meet the capital needs of tens of thousands of credit worthy small businesses that now have nowhere else to turn is equally vital.

Do I still have time left?

Chairman GRAVES. You are over.

Ms. OZER. All right. Sorry. That wraps it up and I will be available to answer any questions.

Chairman GRAVES. You will have more opportunity when we get to questions.

Ms. OZER. Okay.

[The statement of Ms. Ozer follows:]

NATIONAL ASSOCIATION
OF GOVERNMENT GUARANTEED LENDERS

"Access to Capital: Can Small Businesses Access the Credit Necessary to Grow and Create Jobs?"

Testimony Before the House Committee on Small Business

June 1, 2011

Submitted by:

Lynn Ozer
Executive Vice President
Susquehanna Bank
Pottstown, PA

and

Member of the Board of Directors
The National Association of
Government Guaranteed Lenders, Inc.

NATIONAL ASSOCIATION
OF GOVERNMENT GUARANTEED LENDERS

Chairman Graves, Ranking Minority Member Velázquez, and members of the Committee, my name is Lynn Ozer. I am an executive vice president at Susquehanna Bank, where I manage the bank's Small Business Administration (SBA) and government-guaranteed lending function throughout the bank's four state footprint. Susquehanna Bank is a Pennsylvania state-chartered bank that operates 223 branch offices in Pennsylvania, Maryland, New Jersey and West Virginia. The bank has been serving communities throughout the Mid-Atlantic for more than a century.

Susquehanna Bank is a subsidiary of Susquehanna Bancshares, Inc., a financial services holding company with assets of approximately $14 billion and more than 3,000 employees. SBA lending is centrally administered in our Pottstown, PA location. Our SBA loan portfolio has an outstanding balance of approximately $300 million, and we participate in virtually all the programs under the SBA 7(a) umbrella – SBA Express, Export Working Capital, Patriot Express, and Seasonal and Contract CAPLines – and are also a first mortgage lender under the SBA 504 program.

For the past 23 years, I have also served on the board of directors of the National Association of Government Guaranteed Lenders (NAGGL), headquartered in Stillwater, Oklahoma. In addition, I have been a member of the board's Executive Committee for more than 13 years, and chaired NAGGL's technical issues committee for approximately the same period.

NATIONAL ASSOCIATION
OF GOVERNMENT GUARANTEED LENDERS

NAGGL is a trade association with over 700 institutional members that participate in various capacities in the SBA loan programs all across the country. Our members are dedicated to providing critical capital to our nation's small businesses so that these businesses can grow, create more jobs, and contribute to our nation's economic vitality. NAGGL's lender members are responsible for approximately 80% of the annual SBA 7(a) loan volume as well as most of the lender portions of SBA 504 loans.

Thank you for inviting me to testify today on the important issue of small businesses' ability to access capital. Although my experience is on the lending side, many small business trade groups, including the International Franchise Association (IFA), whose representative is also testifying today, have told us that access to credit is the #1 issue for their membership. The IFA and many other similar organizations have found that while their members are ready and willing to take on additional risk to grow their businesses and create more jobs, accessing the capital necessary to support those efforts has proven to be a daunting task during these difficult economic times. To fully understand why, we need to look at what is happening in the banking industry today.

As a result of the recent 'great recession' many banks saw the quality of their assets decline significantly. In its March 31, 2011 *Quarterly Banking Profile*, the FDIC reported that as of that date, the non-current assets (loans on non-accrual and those 90+ days past due) at commercial banks totaled 4.79% of assets. In a normal banking environment that number would be around 1%. In addition, first quarter 2011 charge-offs were at an annualized pace of 1.91%, which is still far above the normal range of .25%-.50%. While improving over the last four quarters, both measurements still have a long way to go to get back to the normal credit-healthy range.

Because of these and other problems caused by the overall ailing economy, over the past several years, federal banking regulators have increased the capital requirements that they impose on banks. The result is a perfect storm of circumstances that together serve to stifle banks' abilities to make credit available to small businesses – fewer earning assets because of problem loans, increased capital requirements, and higher expenses due to additional FDIC insurance assessments.

So how does a financial institution make its regulatory capital ratios comply with the new requirements when it cannot raise capital? The institution shrinks its assets down so the capital that it has becomes a greater percentage of its total assets. And that is exactly what the commercial banking industry has done.

In its *Quarterly Banking Profile*, the FDIC reported that for the first quarter of 2011 (just last quarter): "Total loan and lease balances continued to fall, declining $126.6 billion (1.7 percent). This is the fifth-largest quarterly percentage decline in loan balances in the 28 years for which data are available, and it marks the tenth time in the last eleven quarters that reported loan balances have fallen (the one exception was caused by the implementation of FASB 166 and 167, which resulted in the consolidation of as much as

$400 billion in securitized loans onto banks' balance sheets in the first quarter of 2010)". Although the total amount consolidated cannot be precisely quantified, the industry would have reported a decline in loan balances for the first quarter of 2010 absent this change in accounting standards.

The combination of capital constraints and problem assets coupled with an enhanced awareness of the need for prudent lending in this economic environment has caused many lenders to become even more selective with their conventional small business lending. Loan underwriting standards are significantly tighter today than they were just a few short years ago. The result is that many creditworthy small businesses have difficulty accessing conventional loans to provide the capital that they need to grow their businesses, growth that is essential to the nation's economic recovery.

So how are banks meeting the credit needs of their small business customers? Many lenders have turned to, or returned to, the SBA loan programs, and in particular, the 7(a) loan program which is SBA's largest and oldest loan guaranty program. SBA Administrator Karen Mills noted recently that SBA had brought more than 1,200 lenders back to SBA lending over the last two years, adding: "That means we are getting more access and more opportunity for more small businesses in more communities".

This growth in the 7(a) program is essential to keeping credit flowing to small businesses because the program fills a critical gap for those businesses, particularly startup and early stage companies that need access to longer-term loans. SBA, through its private sector lending partners, accounts for well over 40% of all long-term small business loans made in America, making the agency the single largest provider of long-term capital to U.S. small businesses.

Let me briefly explain how the program works. The SBA has delegated most of the loan making and servicing authority to lenders while reserving the regulatory and oversight role to the agency. A significant percentage of the lenders in the program today are "preferred lenders", which means that SBA has delegated to them authority to attach a federal guaranty to a loan without SBA's full review. Other, generally lower volume lenders, submit their loans through a different process with SBA making the final decision about whether to attach the federal guaranty. In either case, it is the lender that actually provides the capital to the small business. SBA only steps in if the borrower defaults and there is a loss on the loan, and then, only to the limit of its guaranty, generally 85% for loans of $150,000 and less, and 75% for larger loans.

From the lender viewpoint, a key benefit of the 7(a) program is that it takes less capital to support an SBA loan than it does a conventional loan. This is because federal regulators impose different capital requirements on SBA-guaranteed loans, and because lenders can choose to sell the guaranteed portions of their 7(a) loans in the secondary market in order to increase their liquidity.

From the viewpoint of small businesses, the SBA guaranty allows increased access to capital, particularly to the kind of financing that appropriately matches the loan term to the life of the asset being financed – that is, financing long-term assets with long-term loans. According to federal statistics, the typical 7(a) loan has an average original maturity of 12 years, while conventional small business loans typically have original maturities of three years or less (with the significant majority of those loans having maturities of one year or less). Longer maturities allow small businesses to access capital that would not be available to them if repayment were required in substantially shorter periods.

The importance of SBA lending to small businesses is clearly evidenced by the demand for the programs. According to SBA statistics, between its 7(a) and 504 program guaranties, in just the last two years, the agency has helped to deliver $42 billion into the hands of small business owners. When you add the dollar value of the private sector first mortgage portion of the 504 loans, that loan total number goes even higher.

However, the very success of the 7(a) program this year is causing a new problem. Based on loan approvals to date, it appears highly likely that program demand will exceed the $17.5 billion program level ceiling set by congressional appropriators. While sufficient appropriations remain to meet program demand, the program cap will likely cause SBA 7(a) lending to shut down this summer unless the Congress acts to raise the program level. It would be a shame for the program that is best meeting the credit needs of small businesses to be suspended because of an arbitrary program ceiling.

In order to be sure that the 7(a) program is able to meet the needs of its eligible and creditworthy small business applicants, we request that the program level for SBA's business loan programs be increased from $17.5 billion to $19 billion for the current fiscal year. No additional appropriations will be required to support this increase. This action is necessary before the August congressional recess because it is highly likely that the program cap could be reached before Congress is back in session, thus shutting off small businesses' access to this important source of capital.

In closing, on behalf of my bank and other 7(a) and 504 lenders, I want to thank this Committee, the Congress and SBA for the steps that it has taken to revitalize SBA's loan programs and to make them more accessible and cost-effective to small business borrowers and lenders. Over the past several years, working together on a non-partisan basis, SBA and Congress have crafted a number of excellent short- and long-term solutions aimed at jump-starting lending to small businesses. The success of those solutions is readily illustrated by the dramatic increase in SBA lending that occurred subsequent to enactment of the Recovery and Small Business Jobs Acts. The results are clear – unprecedented lending levels in the SBA 7(a) and 504 programs realized last fiscal year, and that are on track to be realized again this fiscal year.

The public-private partnership that exists in SBA's lending programs has been and continues to be a shining example of what can be achieved when the federal government and the private sector — both lenders and other organizations, like IFA that support small business development — work together. We know that small businesses lead the way in creating new jobs, and we know that having a vibrant small business segment in our economy is vital to continuing the fragile economic recovery that we are seeing today. We also know that keeping SBA's 7(a) and 504 loan programs available to meet the capital needs of the tens of thousands of creditworthy small businesses that have nowhere else to turn is equally vital. These loan programs merit continued bipartisan support in the Congress.

Mr. Chairman, this concludes my prepared statement. Thank you for all you have done to support America's small businesses, and for giving me the opportunity to testify before you today. I would be pleased to answer any questions.

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Chairman GRAVES. I will now turn to Ranking Member Velázquez to introduce our next witness.

Ms. VELÁZQUEZ. Thank you, Mr. Chairman. And it is my pleasure to welcome and introduce Dr. Dennis Jacobe. He is the chief economist at Gallup. In this role he leads Gallup's efforts to understand consumer public opinion and the economy more broadly. He has designed many of Gallup's special financial indexes, including the small business index and investor and retirement optimism index. Dr. Jacobe is currently focused on the application of behavioral economics to the overall idea of financial well-being. Welcome.

STATEMENT OF DENNIS JACOBE

Dr. JACOBE. Thank you, Ranking Member Velázquez and Chairman Graves.

I am pleased to be here today. As you mentioned, I am Gallup's chief economist. The comments today are my own, not necessarily those of Gallup.

We at Gallup are concerned about the economy and I will summarize my statement very quickly. But we interview 1,000 Americans every night and we have done so since the beginning of January 2008. And we ask them various questions about the economy and then we look at those results and report on them on a weekly and monthly basis. And what our numbers show us is what you saw on some of the economic data today, and that is the economy is softening. We have seen it for quite a while. We think by asking Americans about how they feel about the economy, that we get some insight into where it is headed. And so although the economic data you are seeing today lags a little bit, we think our numbers are being confirmed by what is happening now, and that is we are certainly in a soft patch, potentially in a stagnation or a stagflation situation.

Some of the numbers that we get show that consumer spending simply has not been increasing and at the same time we are seeing unemployment at very high levels. The number will come out Friday. I am not sure what that will be but Gallup measures its own unemployment rate. Our number for May is 9.2 percent. That is not seasonally adjusted as an unemployment rate, but when we look at what we call underemployment, that is the people who are unemployed or people who are working part-time looking for work, the number goes up to 19.2 percent. And we think people underestimate what the effects are on society and the economy of having one in five Americans unemployed or underemployed.

In addition to this sort of daily monitoring, we do something we call the Wells Fargo Gallup Small Business Index. And what we do in that is we survey small business owners across the country and ask them a variety of questions to try and measure the small business operating environment. I have inserted a chart in my testimony, but basically what happened is early this year, as consumer confidence was up, so was small business confidence. And it was recovering from the last year and a half when it was low. In our latest measure in April, small business confidence went down. We think that does not portend well, but fits with our other measures in terms of the economy overall.

In terms of our credit availability, as part of that index we measure and ask small business owners what they feel the credit is available to them as small business owners. In my testimony I include a chart that shows that about 30 percent of small business owners say that it is difficult or very difficult to get credit right now. Now, that number may seem small but it is about three times what the difficulty of getting credit was rated by small business owners prior to the recession. In terms of getting—whether credit is easy to get, we have about 20 percent who say it is easy to get. Obviously, those that are stronger financially than the rest, but that number is down from over 50 percent prior to the recession. So there is a slight improvement in credit availability for small businesses as has been mentioned by a lot of people, but it is far down from pre-recession levels.

There are a couple of different things that I think are very important having to do with job creation of small businesses. I will not go through that discussion in detail except to say that we find that about 40 percent of small businesses tell us that they are hiring less people than they need. We think that if we can turn that around and actually get them just to hire what they need, not necessarily to grow, there could be really an explosion in terms of job creation that is unexpected by most economists. The question is how to do that effectively.

Three areas that I mention that are not mentioned often, I think, one has to do with education. I would be glad to discuss that but I think there needs to be some tie-in to education from our polling with small businesses. The housing and real estate area, which you have heard more bad news about this week, which is another area that is very important to small businesses, and then finally, some of the energy problems.

I will be glad to answer any questions.

[The statement of Dr. Jacobe follows:]

TESTIMONY BEFORE THE HOUSE COMMITTE ON SMALL BUSINESS U.S. HOUSE OF REPRESENTATIVES

HEARING ON ACCESS TO CAPITAL: CAN SMALL BUSINESSES ACCESS THE CREDIT NECESSARY TO GROW AND CREATE JOBS?

JUNE 1, 2011

Good afternoon, Chairman Graves, Ranking Member Velazquez, and Members of the Committee. My name is Dennis Jacobe and I am Gallup's Chief Economist. Gallup is the world's best polling company and is strictly non-partisan. In this regard, I'd note that my comments are my own and not those of Gallup.

I am pleased to be here today to discuss the current small business operating environment and whether small businesses can get the credit they need to grow and create jobs. In my few minutes today, I'd like to summarize four key points:

- The U.S. economy is currently in an economic "soft-patch" that may not be transitory;
- Small business owner optimism declined in April from where it was earlier this year;
- Credit availability has improved slightly for small businesses in 2011; and
- There is the potential for an "explosion" in new job creation if the nation's small businesses begin hiring the employees they need.

The U.S. Economy Is in Another "Soft-patch"

At Gallup, we remain extremely concerned about the current condition of the U.S. economy in general and the situation facing small business owners in particular. Gallup's economic measures – based on daily interviews with 1,000 Americans nationwide and posted daily on Gallup.com -- continue to show the current so-called "soft-patch" in the U.S. economy is not only real, but may not be transitory.

- Although Economic Confidence improved in May – possibly due to bin Laden's death and the recent slight decline in gas prices – consumers are no more optimistic now than they were a year ago.
- Similarly, consumer spending remains in the "new normal" range of 2009-2010 and far below the recession spending levels of 2008.
- Gallup's monitoring of unemployment shows the not seasonally adjusted unemployment rate at 9.2% and the underemployment rate at 19.1% -- essentially where Gallup's unemployment measures were a year ago. Although the economy continues to add jobs, the growth has not been sufficient to significantly change the real jobs situation.
- There is a real danger of "stagflation" in the months ahead.

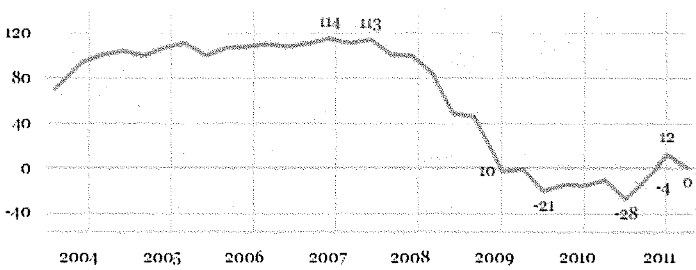
Small Business Owner Optimism is Down from Early 2011

Currently, small business owners tell Gallup that their current operating environment is a lot better than a year ago but down from early this year. One of the ways Gallup monitors the small business operating environment is with the Wells Fargo-Gallup Small Business Index. This is a quarterly survey of small business owner perceptions of their operating environments that was initiated in August 2003. The Index peaked at +114 in December 2006 and reached its low point in July 2010 at -28. By January 2011, the Index had improved to +12 before it fell back to zero in April.

The Small Business Index tends to be a precursor of future economy activity. The latest reading of the index reinforces the idea that the current economic soft-patch will continue in the months ahead.

Wells Fargo/Gallup Small Business Index

The Small Business Index consists of owners' ratings of their businesses' current situations and their expectations for the next 12 months, measured in terms of their overall financial situations, revenue, cash flow, capital spending, number of jobs, and ease of obtaining credit.



Index conducted quarterly August 2003 to April 2011; results for April 2011 are based on 602 interviews conducted with small business owners conducted April 4-8, 2011.

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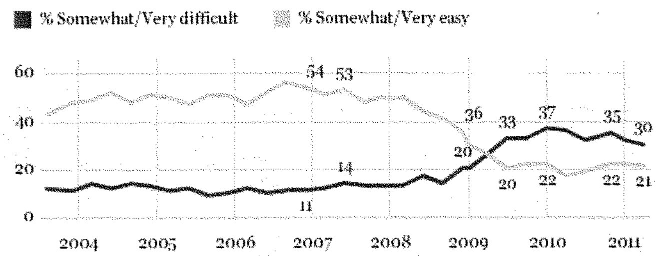
Key drivers of the decline in small business owner optimism in April included a significant decrease in small business cash flows over the past 12 months and an increase in owners' concerns about their financial situation over the next 12 months.

Getting Credit Slightly Less Difficult

Gallup also uses the Index to monitor small business owner perceptions of how difficult or easy it is for them to obtain credit for their business. Right now, 30% of small business owners say it is difficult for them to obtain credit – slightly better than the situation has been over the past year -- but two to three times more difficult than it was in 2006 and 2007. On the other hand, 21% say credit is easy to get – about the same as over the past year but only about half the number who gave us this response in 2006 and 2007.

Wells Fargo/Gallup Small Business Index -- Credit Availability

Over the past 12 months, how difficult or easy was it for your company to obtain credit when you needed it?



August 2003 to April 2011

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Small Business Owners Are Hiring Fewer Employees Than They Need

Half of small-business owners (51%) hired new workers in 2010 – mostly to replace employees, according to the Wells Fargo/Gallup Small Business Index survey. However, of those firms hiring, 42% hired fewer new employees than they needed -- likely a major reason job growth was so anemic last year.

Have you hired as many employees as you need, more than you need immediately, or fewer than you need?

Based on small-business owners who have hired new employees in 2010

	2010
	%
As many as needed	48
More than immediately needed	9
Fewer than needed	42
Don't know/Refused	1

Wells Fargo/Gallup Small Business Index survey November 2010

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The top reason so many of these small business owners hired fewer employees than they needed was that they were worried they wouldn't have the sales or revenues to justify more employees. This was followed by worries about their future cash flows and whether they would have money to make payroll. Third was their concern that they couldn't find employees who were qualified for the positions available. Finally, half of owners say they are worried about the potential cost of healthcare.

Why did you hire fewer than needed? For each of the following, please indicate if it is a reason why you hired fewer than you needed. How about -- ?

Based on small-business owners who hired fewer employees than needed

	2010
	%
As many as needed	48
More than immediately needed	9
Fewer than needed	42
Don't know/Refused	1

Wells Fargo/Gallup Small Business Index survey November 2010

GALLUP

There is the Potential for a Small Business Job Explosion

The hiring efforts of small-business owners in 2010 provide some insights into why generating job growth continues to be so difficult. The most important reason for today's anemic job growth among small businesses seems to be that many are hiring fewer employees than they need. They are doing so in part because they are worried about their future revenues and cash flows -- reasonable concerns, given the small-business operating environment of the past couple of years. Significantly, this is something that can turn around quickly if the economy can gain positive momentum.

Importantly, such a change could create a virtual job explosion far exceeding anything currently anticipated. Just imagine if the 42% of small business owners hiring fewer employees than they need decided to meet those needs. It could quickly turn out that the major issue to worry about would involve how to help the large percentage of small-business owners' who are saying they can't find enough qualified employees for the jobs they have available.

Unleashing America's small business is essential to the future of U.S. economy and job growth. Although there is no silver bullet to get small businesses growing and hiring, reducing economic uncertainty and increasing small-business owners' confidence in their future revenues and cash flows is key to unleashing the hiring of the new employees these firms need.

In this regard, there are three areas concerning the future of small businesses that deserve special attention in addition to those commonly mentioned.

- Education: small businesses have the ability to adjust to rapid changes in the U.S. economy more quickly and effectively than their larger counterparts. However, they are being hampered in that process by an inability of our education system to provide the skilled and talented employees they need. Something needs to be done to integrate the needs of small business with the educating of American workers.
- Housing: the value of housing and real estate normally plays a significant role in small business lending. Further, housing involves numerous small businesses. Stabilization and improvement of housing values would significantly enhance small business lending.
- Energy: although many small businesses have found ways to operate within a high energy cost environment, high and volatile gas prices create major uncertainties for small business revenues and cash flows. Something needs to be done to stabilize energy prices.

I want to thank the Committee for this opportunity to testify at today's hearing. I would welcome the opportunity to discuss my testimony further.

Chairman GRAVES. Thank you. Next I am going to turn to Representative Landry for introduction of our final witness.

Mr. LANDRY. Thank you, Chairman Graves and Ranking Member Velázquez. I would like to introduce Mr. Bob Kottler to you all. Though he is based up here in D.C., Mr. Kottler is a Tulane grad. I think Mr. Richmond—Cedric is not here—is our other—Tulane grad on the Committee.

A former executive at Louisiana's own IBERIABANK and is currently the executive vice president near my hometown at IBERIABANK in Lafayette, Louisiana. And this may make him a certified Cajun. He may be able to understand me if any of you all have problems.

Mr. Kottler has capitalized on his banking and finance expertise and has devoted much of his career to working on what makes small businesses work. In his current role at IBERIABANK, Mr. Kottler is responsible for the retail segment, including retail operations, credit cards, sales, retail training, and small business. Before joining IBERIABANK, he was the executive vice president for small business banking at Capital One, covering Texas, Louisiana, Maryland, Virginia, D.C., New York, New Jersey, and Connecticut. I do not know how you connect Texas and Louisiana to the east coast, but.

His team worked in tandem with Capital One's national small business credit card team. Mr. Kottler also headed Capital One's branch real estate division in the Texas area and served as IBERIA's chief sales support officer before IBERIA and Capital One's merger. Mr. Kottler started his involvement with the Consumer Bankers Association in 1995 as a member of CBA's Small Business Committee. He has been extremely active over the last 16 years in roles such as chair of the Membership Committee and member of the Board of Directors for 10 years. In total, Mr. Kottler has nearly 20 years of practical experience in providing small business access to capital and credit.

Mr. Kottler, thank you for your service to our communities in Louisiana and throughout the other states, and I am proud to have you testify before us all today.

Chairman GRAVES. Thanks, Mr. Kottler. I think Mr. Landry used up all your time.

Mr. KOTTLER. I think so. I should say that was a hard one to follow. I yield.

Chairman GRAVES. Go ahead.

STATEMENT OF ROBERT KOTTLER

Mr. KOTTLER. Good afternoon, Chairman Graves and Ranking Member Velázquez, and members of the Committee. I am excited to be here today.

As Congressman Landry said, I am Bob Kottler and I am responsible for retail and small business banking at IBERIABANK. And also a member of the Consumer Bankers Association Board of Directors. CBA has been the recognized voice of retail banking, including small business lending for the nation's capital for 90 years.

In my positions at IBERIA and CBA and 21 years experience in small business lending, I understand the challenges we face, especially getting through the current economic environment. Over the past few years high unemployment has resulted in less consumer spending, and consumer spending is critical to boost sales of small businesses and make them healthy. The decline in sales and the weak economic conditions have led to weaker than normal and inconsistent demand for small business loans. In fact, a recent FIB study found that poor sales and uncertainty continue to be greater problems for small business owners than access to credit.

In addition to the decline in sales, another factor that has diminished the demand for lending is value of home equity. And as many of you know, home equity is traditionally a strong form of collateral that many business owners use to secure their business loans.

A December study by the Federal Reserve Bank of Cleveland found the decline in home values has constrained the ability of small business owners to obtain the credit they need to finance their business. It is also important to understand how the decline in sales and home values has affected small business lending. When banks underwrite loans, we look at two things—cash flow, both historical and projected, as well as the collateral securing the loan. The decline in these two criteria over the economic cycle have been significant factors behind the reduction in lending and make it clear why lending has been so difficult. But we do see it improving.

CBA members report increases in demand for small business loans. In addition, the Commerce Department denounced an increase in consumer spending for the tenth straight month, which we think is a positive sign that we are turning the corner.

So what is CBA doing to improve lending? Many banks have instituted aggressive Second Look programs where the banks will take a look at a loan that might have been declined and see if there is a way to improve it and are looking to find ways to make more quality loans through that process. A number of banks have also announced new lending programs and commitments to small business, and many CBA members have established enhanced training and incentives through the branches, which is often the primary place our customers come to ask for loans and also specifically improving use of SBA programs.

CBA supported and will continue to support the efforts of the Committee and Congress to expand small business lending and economic development. We believe SBA program improvements, including 7(a) and 504 and express are important, and also the Small Business Lending Fund and other enhancements and all of those things are getting us—taking us in the right direction to make more loans.

This spring, CBA joined with the International Finance Association to sponsor a small business lending summit here in Washington, D.C. And through that summit and the dialogue that we have had with IFA, we have looked for ways to improve lending. As a result, CBA's Small Business Committee is now working to develop a template that franchises can use to prepare their potential franchisees to secure the financing they need. This template will provide the bank information about the franchise and hopefully will help us successfully underwrite the loan.

One final point I wanted to stress is the importance of communications between borrowers and lenders, even before a request is made. The better prepared and knowledgeable a borrower is about the process and the more that a lender knows about the borrower, the more successful the outcome. Small businesses and lenders alike need to work harder to bridge that divide and better understand one another. And that is one of the things that we have been working on with the IFA.

In closing, we are just starting to see signs of growth in our economy but we think we have a ways to go. Any successful small business needs to have sufficient demands and goods in order to have strong cash flows to prosper. And we think as the unemployment rate falls, demand will increase which will continue to improve small business lending and small business growth. And CBA looks forward to working with this Committee and small businesses to strengthen our nation's economy. So thank you for the opportunity to testify and I will be available for questions. Thank you.

[The statement of Mr. Kottler follows:]

June 1, 2011

TESTIMONY OF ROBERT KOTTLER,

EXECUTIVE VICE PRESIDENT, DIRECTOR OF RETAIL

AND SMALL BUSINESS BANKING,

IBERIABANK

ON BEHALF OF

THE CONSUMER BANKERS ASSOCIATION

BEFORE THE COMMITTEE ON SMALL BUSINESS

UNITED STATES HOUSE OF REPRESENTATIVES

"Access to Capital: Can Small Businesses Access The Credit

Necessary to Grow and Create Jobs?"

June 1, 2011

Good afternoon Chairman Graves, Ranking Member Velázquez and members of the Committee, my name is Bob Kottler and I am the Executive Vice President and Director of Retail and Small Business Banking for IBERIABANK – (a $10 billion bank headquartered in Louisiana and also serving Texas, Alabama, Arkansas and Florida). I am also a member of the Board of Directors of the Consumer Bankers Association (CBA). For more than 90 years, CBA has been the recognized voice on retail banking issues in the nation's capital. Member institutions are the leaders in all areas of consumer financial services, including small business lending. CBA members include most of the nation's regional banks, as well as bank holding companies that collectively hold two-thirds of the industry's total assets.

I am pleased to have this opportunity to appear before you today to discuss the issues surrounding small business lending. As we continue to move our economy forward on a path of stability and prudent growth, it is important to engage in constructive dialogue with others who share our goals. In my positions with IBERIA and CBA, I understand the challenges we face in serving our customers, protecting our depositors and navigating through the current economic climate.

As we strive to recover from the economic downturn and are seeing modest employment gains, banks are starting to see signs that demand for small business loans is increasing. For the last few years, we saw weaker than normal and inconsistent demand for small business loans as many business owners were facing lower sales volumes and a negative economic outlook. This observation has been confirmed by a January 2011 study conducted by the National Federation of Independent Business (NFIB).[1] The study found that reported and planned capital spending remain at 35 year record low levels - a clear sign the economic conditions were not conducive to expansion or growth.

The evidence suggests lowering the unemployment rate - the key to many of the challenges facing our nation's economy – is critical to small business success. In its research, the NFIB found a close correlation between sales and the unemployment rate (Figure 1.). As the unemployment rate increased, small businesses saw a decline in sales. In fact, the NFIB study

[1] National Federation of Independent Business, Financing Small Businesses: Small Business and Credit Access, January 2011

found "Poor sales and uncertainty continue to be greater problems for significantly more small business owners than access to credit." [2]

With job creation comes an increase in demand followed by stronger sales. We are slowly seeing an increase in jobs but it remains an uneven recovery. According to an April ADP report[3], small businesses added 84,000 new jobs. Of these, 70,000 were in the service-providing industry and only 14,000 were for goods-producing businesses. Overall, if we can continue to see a decline in the unemployment rate, we can expect to see an increase in sales for small businesses, allowing them to expand and invest in more employees and equipment, and resulting in increased demand for loans.

Another factor affecting credit demand is the diminished value in a traditional form of collateral used by many small businesses – home equity. The values of personal assets are a critical component to the success and ability of small businesses to grow. Federal Reserve Board Governor Elizabeth A. Duke highlighted this in a recent speech. For small businesses with less than 500 employees, Duke indicated "more than 70 percent were

[2] National Federation of Independent Business, Financing Small Businesses: Small Business and Credit Access, January 2011, pg. 1
[3] ADP, National Employment Report, April 2011

initiated using personal savings or assets"[4] according to the preliminary results of the Federal Reserve's 2010 Survey of Consumer Finances (SCF).

A December 2010 Federal Reserve Bank of Cleveland study found "the decline in home values has constrained the ability of small business owners to obtain the credit they need to finance their business."[5] Many formerly qualified borrowers are now struggling to find other sources of collateral needed by lenders to properly underwrite loans. With the housing market expected to remain weak in parts of the country for several years to come, this issue may continue to present challenges for many small business owners.

It is important to understand how a decline in sales and home values has affected small business lending. There are several considerations involved in underwriting a small business loan. Two of the most critical components are cash flows (historical and projected) and the value of the collateral. While banks have been more prudent with their underwriting, the decline in these two most important criteria – cash flow and home/collateral

[4] http://www.federalreserve.gov/newsevents/speech/duke20110414a.htm#f2

[5] Federal Reserve Bank of Cleveland, "The Effect of Falling Home Prices on Small Business Borrowing," Mark E. Schweitzer and Scott A. Shane

values- were reasons behind the reduction in lending. Couple that with an increase in capital requirements and regulatory uncertainty, and it is clear why the last few years have been so difficult, but we see things improving.

CBA members report modest increases in demand for small business loans. The March 2011 Thomson Reuters/PayNet Small Business Lending Index showed a year over year growth of 12 percent.[6] (Figure 2) In addition, the Commerce Department announced an increase in consumer spending for the tenth straight month. While still sluggish, these recent increases in consumer spending have improved the financial health of small businesses applying for these loans and led to an increase in lending. CBA members believe that these changes are a positive sign to suggest we are turning the corner.

CBA members are in business to make loans in the communities we serve and continue to look at the creditworthiness of each borrower intensely. Many of our members have instituted aggressive second-look programs to ensure no stone is unturned when finding ways to make more, quality loans. These second look programs are resulting in more approvals.

[6] http://thomsonreuters.com/content/financial/pdf/i_and_a/indices/small_business_lending_index_0311.pdf

A number of banks have announced enhanced lending programs and increased lending commitments for small businesses. Many CBA members have also established enhanced employee training and incentives to improve production through local branches, and others have hired additional small business bankers specifically tasked to improve delivery of SBA 7(a), 504, and Express/Patriot Express programs and to determine additional opportunities.

As a lead association in the matter of small business lending, CBA has supported, and will continue to support, the various efforts of this Committee and Congress to expand small business lending (i.e. SBA program enhancements, Small Business Lending Fund, etc.) and to stimulate economic development. We believe these lending enhancements, if utilized, are steps in the right direction.

With regard to the Small Business Lending Fund, CBA understands that many of the banks that qualify for the fund are concerned about the possible stigma associated with the program. We have also heard of numerous complaints about the approval process and lag in disbursement of funds. While we support the intent of the SBLF, it doesn't change the heart of the problem - the overall financial health of our economy and the resulting impact on borrowers.

What are banks doing to make things better? CBA and its member institutions remain committed to improving the small business lending environment. As part of our efforts, on April 7, 2011, CBA, along with the International Franchise Association (IFA) and several other organizations sponsored a Small Business Lending Summit in Washington, D.C. Through the summit and the ensuing dialogue, CBA and IFA aimed to partner with key stakeholders in the small business, financial and government policy/regulatory communities to seek ways to unleash the power of small businesses and aspiring entrepreneurs to create jobs through increased access to credit.

CBA was represented at the summit by top small business lenders. We firmly believe the summit was an important first step toward establishing a continuing dialogue between the franchise business community and leaders in small business lending. We look forward to working with the IFA and other key stakeholders toward the shared goal of increased lending by streamlining the loan process for franchisees.

CBA has commonly found that many franchisees do not get loans because they are often inexperienced in obtaining a business loan, which is a different process than many other loan types. Banks want to know about the franchise itself, how long it's been in business and how successful other franchisees have been. To close this gap, CBA's Small Business Committee is in the process of developing a template that franchises can use to better prepare their potential franchisees to secure the financing they need. The template will provide the bank with information about the franchise brand that may help to successfully underwrite a loan.

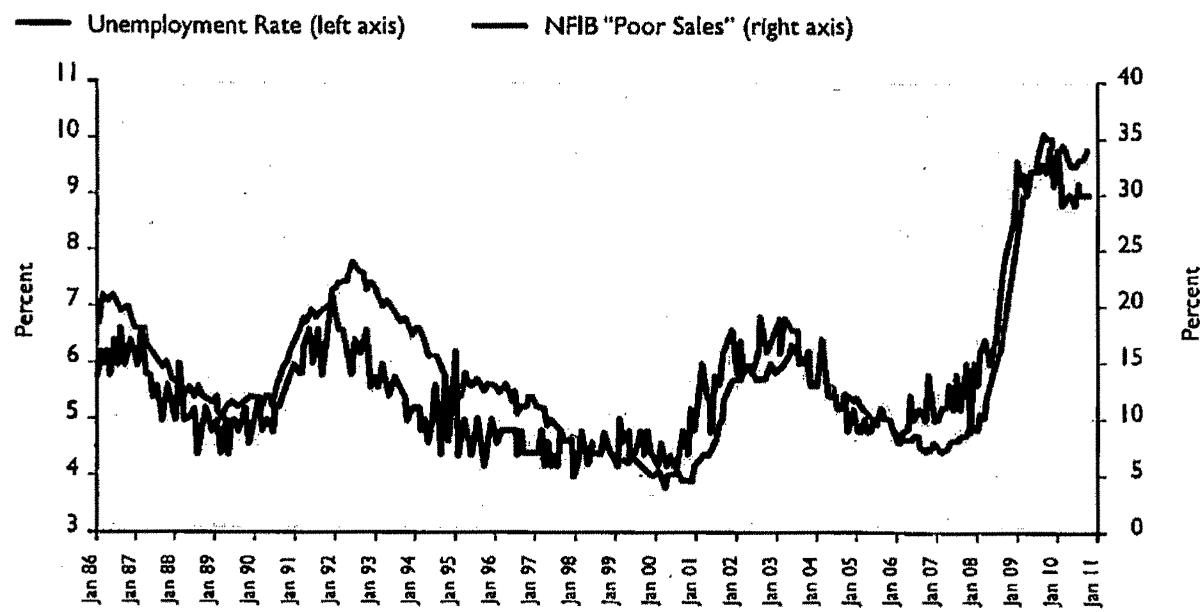
Finally, I would also stress that communication between borrowers and lenders is critical. Borrowers and their banks should work hard to form and maintain relationships long before a specific loan request is made. The better prepared and knowledgeable a borrower is about the process, and the lender about the borrower, the more successful the process. Small businesses and lenders alike need to work harder to bridge the divide in order to better understand one another with respect to credit needs and approval.

In closing, we are just starting to see signs of modest growth in the economy but we still have a ways to go. Any successful small business needs to have sufficient demand for the goods or services it provides in order to have the cash flows to prosper. As we see the unemployment rate fall, demand will increase, resulting in improved small business lending and small business growth. CBA and its members look forward to working with this Committee and small businesses to strengthen our nation's economy.

Thank you for the opportunity to testify before you today. I am happy to answer any questions you may have.

Figure 1:

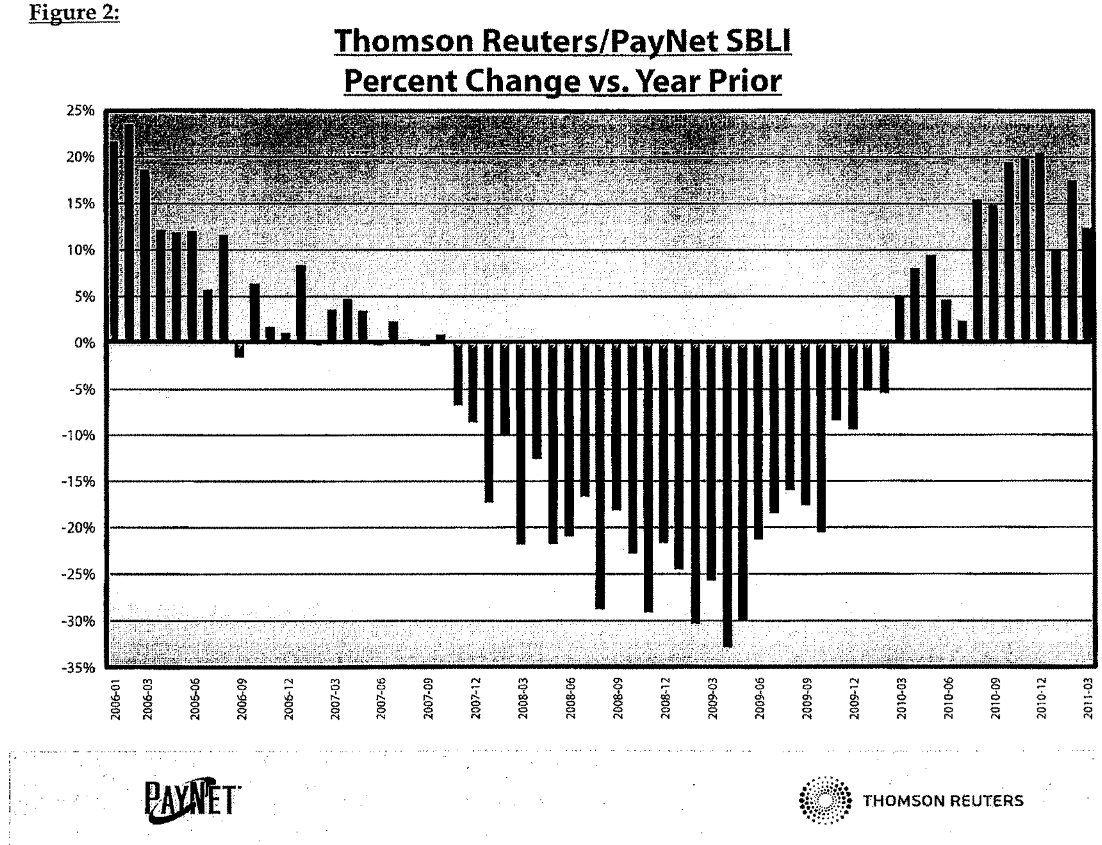
POOR SMALL BUSINESS SALES PARALLEL THE UNEMPLOYMENT RATE
JANUARY 1986 TO OCOTBOER 2010



Courtesy: Merrill-Lynch

Business and Access to Credit

Figure 2:


Thomson Reuters/PayNet SBLI
Percent Change vs. Year Prior
25%
20%
15%
10%
5%
0%
-5%
-10%
-15%
-20%
-25%
-30%
-35%
2006-01
2006-03
2006-06
2006-09
2006-12
2007-03
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2008-03
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2009-03
2009-06
2009-09
2009-12
2010-03
2010-06
2010-09
2010-12
2011-03
PAYNET
THOMSON REUTERS

Chairman GRAVES. Thank you, Mr. Kottler.

I am going to pass my line of questions to the end of the hearing because I have a lot. But I am going to turn to our first member, Mr. West, for questions. Five minutes.

Mr. WEST. Thank you, Mr. Chairman. Also, Ranking Member Velázquez. And thank you, panel, for taking the time to be here with us.

We just had a very interesting morning. We went over and met with President Obama and one of the interesting topics we brought up is what we are discussing here today as far as lending. And especially the regulatory burdens that we place upon our small businesses. One of the things that the president said was that these are independent regulators dealing with small businesses and they really—the government does not have any effect upon them.

So what I would like to know is, is that really the case? Or have you seen an increase of government regulators coming down that are restraining or restricting the lending practices for our small banks? Because that is a very important relationship we have to our small businesses. So I will defer to our bankers first and then, of course, Mr. Hall.

Ms. OZER. What we found is that the FDIC regulators are inconsistently applying regulations throughout the banking community. That is what has been reported to the trade association.

Mr. KOTTLER. I think the banks that are members of CBA have not seen a lot of regulatory impact. We are always concerned about it but I ultimately think that it is really improvement of the economy that is really keeping more loans from being made. And that is really the primary influence.

Mr. HALL. Well, from our—by the way, Mr. Landry, I am from Texas. No problem understanding you.

Mr. West, I think the issue is, from a franchise perspective, we are hearing that our borrowers are being inconsistently treated in some ways or that the bankers are being inconsistently treated. At least that is what the bankers are telling us. I have some banking interest myself and I do know it is very difficult for the individual banks to know what to do. They are sort of just like we are in our business. It is very difficult times for the small banks. And so I do—we hear on the franchising side that there are significant restrictions on credit based on the inconsistency of the regulators. And I am not—I do not know enough about it. I am not trying to pick on FDIC or anybody else. We are just trying to find a solution to the problem.

Mr. WEST. Can you all give examples of these inconsistencies? Just one or two maybe.

Mr. HALL. I can tell you what I heard but I do not want to—these are the bankers. I will defer to the bankers. Unless they do not answer and then I will tell you.

Mr. WEST. Hot potato.

Mr. HALL. Okay. You know, what we hear is that the SBA loans—and again, I know we had Mr. Grumberger, who is the vice chairman of the FDIC, speak at our credit conference. He clearly said we are trying to help you in this effort but we hear what is happening is that it is not getting filtered down to the local examiners and that what is happening is that at the local examination level they are looking at SBA loans as being some risk—more risky because they are guaranteed. And therefore, are substandard. And so they are getting pushed over into a more restrictive line within the individual banks. We think franchise loans are good loans but because they are SBA loans there is apparently some bias against that. Again, I am not—I am only answering because you asked me the question. So.

Ms. OZER. Well, this is the same information that we have heard as well. And some banks on the government guaranteed loans are asked for higher reserves than others on the same guaranteed versus unguaranteed portion. So it has been handled inconsistently. And then just exactly what Mr. Hall was saying as far as the classification of the loan and the risk rating, and then that naturally affects how much capital has to be reserved for those loans.

Mr. WEST. Absolutely. Well, thank you.

And Mr. Jacobe, one question. In your estimation, what are the two economic policy silver bullets that would enhance access to capital for our small businesses and help us to sustain a growth environment?

Dr. JACOBE. I wish there were silver bullets, but two things that would really help. I think one is stabilizing the housing and real estate markets. I think that as you hear from the bankers in terms of how small business loans are made, and I have worked with bankers for 25 years and they tell me the same thing. And that is a lack of collateral. A lot of that is related to the housing situation.

The second thing has to do with education. When we did our polling prior to the recession and prior to the financial crisis, one of the things we found was that small businesses had problems finding people who were skilled and had the skills they needed so that they could grow. That remains a problem. And when we have polled recently, among the other problems they still cannot find the skilled people they need and talented people they need in those areas that are growing. So those are the two things I would focus on.

Mr. WEST. Thank you very much. I yield back, Mr. Chairman.

Chairman GRAVES. Ms. Velázquez.

Ms. VELÁZQUEZ. Thank you, Mr. Chairman.

Dr. Jacobe, in your testimony you discussed that while credit conditions have improved for small businesses, they are still considerably tighter than they were in 2006–2007. And I know that you mentioned three factors, one of them the housing and real estate markets. But do you see, based on the surveys that you take every night, any conditions that are improving so that we could be to a point where we were five years ago?

Dr. JACOBE. Well, actually, until about January of this year we started to see a lot of things improving. And I thought we actually were going to build some economic momentum. And that has been sort of dashed in the last couple of months.

I think that we could build surprising economic momentum and we could really get back there if we can unleash this kind of pent-up demand in the small business sector and just do a few things basically nationally that we could really recover very much more quickly than people think.

Ms. VELÁZQUEZ. Can you imagine where we would be today if we were not infused capital in terms of helping prevent the capital collapse—the capital markets from collapsing?

Dr. JACOBE. That is really interesting. Last night I was watching Too Big to Fail. And during the period of time when all those events took place, I was polling nightly not only national consumers but also banking customers. And I could identify very well with some of the feelings that are portrayed in that show. It is really hard for people to go back and imagine what conditions were at that time. But at that stage I was among the group of people who would support almost anything because we were really afraid that things were going back to the stages of the 1930s. Now, I know a lot of people do not agree with that anymore but that is where we fell.

Ms. VELÁZQUEZ. And it is interesting that you note that the small business index had increased 40 points between July 2010 and January 2011. What do you attribute this increase to? And do you think that the federal stimulus played any role?

Dr. JACOBE. Well, I certainly think—and people disagree about how effective the federal stimulus was and all of those kind of things. But we really did see the economy start to recover from a really bad point about a year ago. And our numbers and consumer optimism and everything really did start to pick up late last year into early this year. I think it was a combination of things having to do with a lot of uncertainties being removed in the economy and people were much more optimistic.

Ms. VELÁZQUEZ. And you just made a comment that the economy is softening. And given the numbers that we heard in terms of job creation, adding only 38,000, and that could have an impact on capital availability or credit availability for small businesses. Up to this point, last year we passed the Small Business Lending Fund under the Department of the Treasury and it is supposed to provide capital to the banks so that they could lend to small businesses. Up to this point, only 626 financial institutions have applied for the Treasury's SBL. And none have been approved yet. So do you see this initiative having a major impact on small businesses' ability to secure capital?

Dr. JACOBE. I do not think that anybody really expected to have a huge impact from that program. At least the people I talked to, particularly out in the banking business, that that was really going to turn things around. And so I am not really surprised by the result. There are a bunch of issues around that program that just make it difficult for small banks to take advantage of it. And I am not sure that it will help in what I see as softening that is coming.

Ms. VELÁZQUEZ. When we were debating the legislation that created the Small Business Lending Fund, one of the concerns that I raised was the fact that in the language there was no requirements to the banks to lend. If you take that money, if you access that money, it should go to small businesses. So in light that we did not have—we do not have that requirement, would you—what do you think will have—the impact it will have on small business access?

Dr. JACOBE. I am not really optimistic that the program will have a major impact. It is a little uncomfortable for me because I think conditions are bad enough that we ought to do anything we can. So anything that provides hope in this kind of area I am for. But, you know, in terms of expectations, I would not have great expectations.

Ms. VELÁZQUEZ. I will have questions for the other witnesses but I will do it in the second round. Thank you, Mr. Chairman.

Chairman GRAVES. Ms. Herrera Beutler.

Ms. HERRERA BEUTLER. Thank you, Mr. Chairman. And my questions are going to be a little bit more directed to you as well.

I really found it interesting in the survey you provided us when 40 percent of our small businesses are not hiring as much as they could—and we are not talking about—it is difficult to create new businesses. Right? In my state legislature I hear a lot, let us get new capital and expand. And I kept thinking we need to protect the business owners who are currently—those small guys who are struggling right now should be our immediate focus. That is the quickest way to get job growth in our country.

I have 13, 14 percent unemployment. I have had double-digit unemployment for three years now in my biggest counties, and it is because we are primarily a small business-based economy. And I was looking through these answers that they gave you. Seventy-nine percent said they were worried revenues or sales would not be able to justify the new employees. Right? So nobody is going to buy what they are selling so it is not worth it to expand. Worried about cash flow or ability to make payroll. I can tell you I have had a lot of small business owners who have not taken a paycheck in several years to keep their employees employed. Hard to find qualified employees, which alludes to your education component.

And then worried about the potential cost of health care. That is something we have not talked about at all here and we had a panel on it a couple of months ago. The only thing that I was surprised I did not see on here is with regard to the regulatory environment. And maybe health care fits under that. But this is really much more—I mean, this is much more big picture. It is not this regulation or that regulation. Is that not something that even registered with this part? Or is that—or am I—or was it cloaked in the answers for these questions?

Dr. JACOBE. I think it is overcome by the other answers. It is sort of under there somewhere. And when we have had larger sample sizes it does show up but it is a much smaller percentage.

Ms. HERRERA BEUTLER. That gets that specific. It is a regulation. Okay.

Dr. JACOBE. Yeah.

Ms. HERRERA BEUTLER. So going back to the certainty and the confidence issue, you know, you had three suggestions or solutions. Each one of them could take us a significant amount of time. You know, how do we stabilize the housing values? And education is obviously more of a state responsibility but there are federal workforce programs that we could align perhaps. And then energy. And I know we are working on gas prices here. You know, get more supply out there and hopefully we can drive down the costs. In getting to these three, where would you suggest we start?

Dr. JACOBE. I think that the most important thing that could be done, and I know this is not the view of a lot of people, is that we need to do something about housing. I think that housing has effects across the country that are underestimated. It has had a major impact on small business. On the collateral small business has, the ability to end, the wealth of the American people. And in terms of going forward, we have a broken housing finance system. I used to be a housing economist many years ago. And if you go back in history as to how housing was really stimulated, that has a tremendous impact on communities and on growth of small businesses, and then on a country. So I know that is not a topic that is being generally discussed but I think that is really—we are not going to get this economy going to potential without housing. If we get housing going, I think the growth is going to be a lot faster than most people think.

Ms. HERRERA BEUTLER. Thank you. And I yield back.

Chairman GRAVES. Ms. Chu.

Ms. CHU. Mr. Kottler, you talked about the decline in lending having more to do with drops in cash flow and home collateral values over the years. And that increased capital requirements and regulatory uncertainty have made it difficult to lend. But I wanted to look at the underwriting standards. What are the current underwriting standards for applicants seeking loans for their small businesses? And have they changed over the last three years?

Mr. KOTTLER. You know, I think that as the economy worsened, there is no question that banks became—banks were worried about the uncertainty and certainly spent a lot more time asking questions of borrowers and making sure that we would make loans that could be repaid so we did not replicate the problems that caused some of this in the first place.

I think we really look at three things when we underwrite a loan. First is the cash flow of the business, both how the business has done historically and then the projected cash flow. So what kind of contracts do they have? What kind of opportunities do they have? And I think one of the difficulties has been that obviously as the economy has been tough over the last couple of years, the historic cash flow of our businesses do not look as good as they did in the years before the downturn. So that certainly goes into the underwriting.

The second piece is the secondary source of repayment or the collateral of the borrower. And that is where housing has come in. Commercial real estate appraisals come in. And clearly we have all been very cognizant of making sure that appraisals are right. And that they represent the true value of the property.

And then the third is generally, especially in small business, the personal guarantees of the business. And we will look to the owner of that business to make sure that they are strong and can also support the business through any issues it would have. So I do not know that it is as much that the underwriting has changed more than being very cautious to make sure to go through each of those steps and in a lot of cases the borrower does not look as strong as they did in the years before the downturn.

Ms. CHU. Are there any barriers though in the process that could keep a business owner from securing a loan even though they actually might be a good candidate for the loan?

Mr. KOTTLER. You know, I am not aware of any. I mean, I think that, you know, banks are in the business of lending money. It is what we do. And I think that we all want to make loans. I can tell you in my business, if it grows, that is what we want it to do. So I think the real issue is just getting the economy on track, getting the jobless rate down, removing any other uncertainties that would cause small businesses from expanding. I think if those things happen, then I think we will begin to make loans. I will also tell you that our lending is up considerably from the bottom, but we are still not all the way back to where we were as an industry and as an association or members from the top.

Ms. CHU. I looked with interest at this program by the Consumer Bankers Association of which you are a member of the board of directors, the Second Look program.

Mr. KOTTLER. Yes.

Ms. CHU. So what would trigger a second look at a good candidate for a loan?

Mr. KOTTLER. I think that, you know, oftentimes loans will get declined by an underwriting. And so what we did is when that happens we put—many of our member banks put processes in place to have a supervisor or their manager or another underwriter take a look at those loans to see if there is another question we could ask, more information we could get, additional collateral that would make a bank comfortable. But something to try to take a look to see how we can make loans. And our members have seen anywhere from—we polled our small business committee—anywhere from three to 20 percent lift in the approval rates of those loans. So it has actually worked—it has been something that has been successful in helping small businesses for our industry.

Ms. CHU. Ms. Ozer, you look like you have something to say on this.

Ms. OZER. What I was going to add is the Second Look program is just something that a lot—that we do at Susquehanna and other banks that participate heavily with the Small Business Administration. We do a second look see if we can utilize the Small Business Administration's guarantee on these loans that do not meet our credit criteria on a conventional basis. The credit criteria of our bank, in particular, and I believe I am speaking for most banks, has—the credit box itself has tightened due to regulations and losses and so forth. But what that means is that the businesses that no longer qualify for conventional lending fall off their plate and land on mine as the director of government guaranteed lending. So that is why we have been doing more loans because we do look at the same exact criteria that Mr. Kottler was speaking about but with the enhancement of the government guarantee, we are able to make more loans to small businesses by utilizing that. And that is why the vitality of that program is so important.

Ms. CHU. Thank you. I yield back.

Chairman GRAVES. Mr. Mulvaney.

Mr. MULVANEY. Thank you, Mr. Chairman.

Briefly, I think one thing we heard earlier bears repeating. I was as surprised as Colonel West was when we met with the president this morning and were told by him from his own mouth that he had very little direct control over the regulatory environment. And Ms. Ozer, you mentioned that one of the hurdles that you had been facing in your business dealt with the FDIC. So I ask you, ma'am, who oversees the FDIC? Is it Treasury?

Ms. OZER. I think it is an independent agency.

Chairman GRAVES. They are under Treasury.

Ms. OZER. It is under Treasury.

Mr. MULVANEY. I believe it is under Treasury, which would be Mr. Geitner, who is a presidential appointment. We actually have a meeting with Mr. Geitner in a few minutes so I am going to ask him directly about his role over the regulatory environment. I was very surprised to hear that.

But let us come to the issue at hand. And I have a question for Mr. Kottler. You heard Mr. Hall talk about the role that franchising plays. I have been a franchisor. I have been a franchisee. And he is absolutely right. There is a tremendous pent-up demand in our industry.

Traditionally, our industry has been sort of a stabilizer. It has been countercyclical. When business got bad and people got laid off, they would turn to franchising as a way to start their own businesses. We saw that in our own business. The demand for our restaurants went up dramatically but the ability of people actually to open them fell to zero because no one could get financing.

Mr. Kottler, let me ask you this. You talked about what is preventing you folks from lending, and I heard all the things that I would ordinarily expect, which is our cash flow and your collateral. It makes perfect sense to me. But my question is this. Is there anything that we can do or perhaps undo as a government to help you lend money? And I will give you the example that I take from another industry, which is the real estate industry which is having a great deal of difficulty refinancing right now. And it is in large part because of regulation. That there is a rule in place now that says if you refinance a real estate loan, even though it is perfectly healthy and performing, if you refinance it automatically goes into a troubled asset category. And to me that shows some opportunity for us to fix things.

So I put it to you, Mr. Kottler, what can we do or undo to help you lend money to folks like Mr. Hall?

Mr. KOTTLER. You know, I think one of the things is be supportive of the SBA programs. A lot of our banks use them. And the increases that were done and the amount to lend and some of the other things that were done there have been pretty important and banks have used that pretty aggressively through this economic environment to make loans.

I think that is the primary thing other than just the more global economic things that I just think we have to continue to work on. And that will take care of a lot of it in the process.

Mr. MULVANEY. Mr. Hall makes an excellent point and you talked about the fact in your testimony that if there was no SBA, if there were no SBA lending out there we would have almost none in our industry. Have you ever done an SBA loan?

Mr. HALL. No, sir. I have not.

Mr. MULVANEY. Has anybody—well, I know Ms. Ozer has. Ms. Ozer, could you tell us the difference in terms of the paperwork involved behind getting an SBA loan and a traditional loan? Maybe Mr. Kottler could help on that as well because it is not apples to apples. It is much more difficult to get an SBA loan than it is an ordinary free market loan.

Ms. OZER. The amount of credit information that is required from the borrower, the basic credit information is the same. In order to do your due diligence and the underwriting process that the congresswoman had asked about before, we need the same amount of financial information. However, when you are applying for an SBA loan, there are rules and regulations, standard operating procedures that have to be followed. So if you decide to borrow money from a bank who has expertise in that area, there should not be a huge amount of difference for the individual borrower. But you do need to have a lender that has experience in that because there is credit underwriting on the bank level and then there is credit underwriting that has to be done on behalf of the Small Business Administration. So there is basically two times the amount of work. You can use the same credit underwriting but you do have forms and applications that need to be done, eligibility checklists that need to be done, tracking of use of proceeds. And there is more of an administrative burden on the bank to do an SBA loan. But the borrower themselves should not really be experiencing more problems.

Mr. MULVANEY. I had the great pleasure of having an SBA loan one time. It was a great experience, do not get me wrong, but if it was between going the SBA route and the conventional route, the conventional route was always preferable.

Yes, sir, Mr. Hall.

Mr. HALL. Well, I would add that while I have not had an SBA loan, it looks like I am going to be going after one. And that is— I will just give you the real world perspective on that. In the past, you know, if I am putting a unit in or put a restaurant in, I am typically putting a lot of capital in there already in addition to the loan. And in times past I may not have had to guarantee the loan personally. In fact, I would not do it unless I absolutely had to. In today's environment, every bank is making me guarantee that loan personally. So now faced with the fact that I probably cannot get the loan at the commercial bank, I am now saying, okay, well I have got to go through SBA. If I want to expand my Dairy Queens, which I am currently looking at right now, I am probably going to expand my Dairy Queens to refurbish them through an SBA program because that is really the only route I can take.

Now, am I excited about, one, the paperwork, and two, personally guaranteeing it with everything I have when I am putting a lot of capital into it? No, I am not, but I do not really have a choice if I want to renovate my units. So that is the response about the SBA.

Mr. MULVANEY. Thank you, Mr. Hall. Thank you, Mr. Chairman.

Chairman GRAVES. Mr. Peters.

Mr. PETERS. Thank you, Mr. Chairman.

I want to talk a little bit about—bank to the bankers' situation with making loans. And I know how the deals have changed but there seem to be two issues with the banking industry that I found in talking to my community bankers, credit unions, and others. Is that certainly the deals that are coming to you are different. Cash flow is different and collateral is different. But in terms of some of the questions we have been getting from some of the other panelists as well with the FDIC involvement is that oftentimes the FDIC will go into a community bank, for example, is what I am hearing, and I would like you to respond, is that they will go into a community bank and say, basically looking at your portfolio and seeing your collateral that you have backing up your portfolio, real estate, for example, has dropped so your collateral has dropped. As a result of that you need to have increased reserves which seems to be a prudent thing to do, is to increase reserves as your collateral has dropped. But that, of course, limits your ability to lend because you either have to bring in private capital, which is a difficult thing to do in a tough economy. A lot of small banks do not look like a great investment to people, particularly in my area, or you have got to actually call in loans or reduce your ability to lend.

So the question to the two folks from the banking industry, to what extent is the fact that you are having trouble finding credit worthy borrowers? And to what extent is it the fact that just because your own portfolios have dropped, the collateral has dropped in value and you simply do not have the capital to lend? What is that balance?

Mr. KOTTLER. You know, I can tell you from our experience at IBERIABANK, we have been very well capitalized and had very good lending performance through the cycle. So I will tell you that one of the reasons that I came to IBERIA was to do more small business lending. That was something the bank management and the bank wanted to do. And as a result, I do not think—my experience is, at least at our bank, that that has been an issue. The issue is really——

Mr. PETERS. More broadly than your bank? Is it an issue?

Mr. KOTTLER. You know, it is interesting. I have attended some different forums over the last few years and some of the smaller banks have certainly raised that issue. But I will tell you from my experience at—our bank has $10 billion and my experience at a larger bank, I do not think it was.

Ms. OZER. My experience with our bank is similar in that we have been capitalized and have been able to lend through the crisis. We do have issues with loan loss reserves. And on a conventional basis, they are looking more closely because of regulations and the types of collateral that they are able to use. The equity values have decreased but we have available to us, the way to make loans, is to utilize the government guarantee. And we have been able to do that and to conserve capital because that is one of the major things that that program allows us to do. The credit worthiness of the borrowers, you know, at the present time the people that you are looking at now that come in to borrow money, their expenses are lean and mean and most of them have a top-line problem and not a bottom-line problem because of the consumer spending.

And those are the things, you know, that makes the banks nervous and, you know, we use the government guarantee to do that. On a conventional basis, a lot of banks are requiring borrowers to pay off their credit lines that they have utilized all the way and they do not have availability on it. And then with an SBA guarantee, we can give them 10 years to repay that loan as opposed to the banks requiring only a two, three, four year loan. So by applying a guarantee to it, we increase the working capital available to those borrowers to keep them in business.

Mr. PETERS. Let me jump in though with your use of the SBA which is an important part for you, is that there is some discussion on the fees that are assessed on SBA loans. Traditionally, those fees have covered all the costs of the program. However, now it is being subsidized. And I know the administration and others have concerns about the subsidy of the fees. All of the fees can be relatively high for a small business right now. What impact do you think it would have if we are in a position that we do not subsidize those fees and actually have to raise those fees? Are you concerned? Maybe that is to all the panelists. Are you concerned about having to face even higher SBA fees?

Ms. OZER. On a personal basis, I mean, the borrowers have that concern but this also touches on what Mr. Hall was saying. You know, when you utilize an SBA guaranteed loan, it is because credit is not available elsewhere. So these small businesses are either fighting to stay in business or they want to fight to start business. And the fees can be financed and amortized over the life of the loan which is generally a longer period of time than they would get on a conventional basis. So as a lender, yes, it is concerning. As a borrower, I am sure that it is concerning as well, except for that if you are in a situation where it is the most reasonable way to continue in business or start in business, then we are going to continue to do it.

Mr. HALL. You know, I have a financial background, a CPA, which I started eight years doing that and I have been an entrepreneur since then. Unfortunately, the question I would ask the bank now is not about the fees but what is the payment. It is a situation where you need the credit. You need to finance something. You are going to pay a higher fee and be willing to pay a higher fee than you ever thought you would. It is the same as the example I gave on the personal guarantee. There was a time I said I would never personally guarantee a note again. Well, I am eating those words today because to get a loan, to expand or even survive, I am going to have to guarantee it personally and put on the table everything I have worked for all my whole life. But I have to do that to grow.

Mr. PETERS. Thank you, Mr. Chairman. I yield back.

Chairman GRAVES. I am going to jump in here real quick because we are going to have a series of votes here coming up here after a bit. I do not know when they are.

But I do have a question for you, Mr. Hall. You mentioned earlier, and I have heard this, too, about a possible bias out there against franchises making it harder for franchisees. In fact, I have friends who are trying to get loans for start-ups that are new franchises. And they get that impression that there is a bias against or that it is much tougher. Can you expand on that a little bit? And I would be very curious to hear what the others have to say in the banking community.

Mr. HALL. Well, you know, I think historically people have had a negative thought about the restaurant industry and about startups just in general because, you know, the SBA program is not about giving away money to loans that will not pay back. I mean, it is a program where you really have to pay the money back and there has to be a plan in place.

So I think there probably has been traditionally a bias against some of the franchises. But I think we are turning that around, partially with the work the IFA is doing with these other organizations. Because to us it is about—we look at it as the glass is half full, rather than half empty. We are not putting the blame on you guys. This is our responsibility. We have got to operate. We have got to grow. And the way we are doing that is working together as a group with some other people that need to make loans. And the things that we are doing are like the underwriting issue that was brought up earlier. We accept some of that responsibility. We probably were not given the right information to these folks because we did not know what to do.

So through the leadership of Steve Caldeira and the IFA, we are creating this environment where we are showing our members, both franchisors and franchisees, how to make that loan application and the things that the bank needs to be successful. So hopefully, we are going to overcome that bias that I think has been out there. But I certainly know that it has been there but our effort in the future is going to try to overcome that.

I do not know if that answers your question.

Chairman GRAVES. Any other thoughts? Anybody?

Mr. KOTTLER. I will add that I think that start-up loans are the most difficult loans to finance. They oftentimes have the least equity going in. They are oftentimes people who may or may not have been in that business and want to do something new. So I think the issue is less of a bias and more of just they are harder to do.

So I think one of the things that we have talked about with IFA is our CBA's Small Business Committee has put together a template with a series of questions for the franchise. How successful your franchise has been and a whole series of questions. And we are hoping as an industry that by starting that communication that we will have more success with start-ups because I do think they are the most difficult things to do.

Chairman GRAVES. Let me back that up with a question. And I would be very curious to hear from everybody. When it comes to start-ups and, this is the age-old question. If you are not wealthy, you are very limited when it comes to your personal guarantee. But you are trying to do a start-up and you have a good business plan. Is there anything that can be done to make that process a little bit easier? Because those are the people that I worry about more than anything else. We have got some great ideas out there in many cases but if that individual is not wealthy, they do not have the personal backing or that personal guarantee, the equity, out there. So what can be—is there anything that can be done? And I will just run right down the line and I will start with you, Mr. Hall.

Mr. HALL. Well, you know, traditionally what has happened is those initial entrepreneurial-type efforts have been financed by friends, family, other outside people. They beg, borrow, and steal. Whatever they have to do to get—probably the wrong words—but they do whatever they have to do to get started. And I think that is sort of what has happened. So I think also in the franchise industry, as well, we have a lot of people coming into that that their initial capital is coming from what we call angel investors, which is somebody that has a personal relationship with them. Very difficult to get any institutional-type investor to get involved in any kind of these small business-type loans that we are talking about.

But as a rule, I think that initial capital comes from just the effort from the individual. Very seldom in my history of being in business have I seen a start-up like that be able to go in and find a place other than through some foundation or something, get the start-up monies. So my personal experience is normally they have to take the first step to get into business, which is one reason we love the franchise business because they are not taking that first step totally by themselves. They can accumulate some of this money, they can get in business with support from someone else to help them be successful going forward and to grow.

Chairman GRAVES. Senator.

Ms. OZER. I agree totally with what Mr. Hall was saying. When you look at, as I have for years, projections and business plans to begin with, we see lots of people that we suggest they go back to the Small Business Development center. So they go to the SBA offices, SCORE offices and so forth, to work on their business plans. But the initial equity when you talk about that, that is the most difficult part. The hardest loan is the start-up capital. They go to friends and family and angel investors, but we will not do 100 percent financing. And what we find, a lot of times what I see is that these people have accessed money from credit cards. And a lot of times we see that that is how they start their businesses. And then if they do have this wonderful idea they come to us where they have already proven some top-line success and they have credit card debt. And that is one of the beauties of SBA lending. We can refinance credit card debt over a longer period of time because they have already proven that they can prove it on a small basis. And that is how they get it.

But the initial capitalization, if you do not have it, you have to get a gift letter from your friends and family. You have to get investors. If you could sell the bank on your idea then maybe you can sell it to somebody else and bring on partners and so forth because they do have to have some percentage of monies to do that.

I have information here on the percentage of start-up loans that were done by the SBA if you are interested in hearing that.

Chairman GRAVES. Very much.

Ms. VELÁZQUEZ. Mr. Chairman, will you yield?

Chairman GRAVES. Yes.

Ms. VELÁZQUEZ. I do, too, by the way. And that is my frustration. Because when we passed the Jobs Creation bill, it was with the purpose of helping provide capital, affordable capital to those who were not able to get it through conventional financial institutions. And what we have seen is that the federal government and SBA is guilty as charged because what we are seeing is a concentration on big loans. Those—we increase the loans from two to five million, and the percentage of smaller loans defined as those less than 150,000 has declined through SBA guarantee loans from 17 percent to eight percent.

So the problem with this recession compared to other recessions is that people lost their jobs and they started up businesses. They created businesses. This time around, because credit standard has tightened and SBA has not helped because basically those guarantee lenders are concentrated on making the big loans. Debt financing does not create jobs. Start-ups——

Ms. OZER. With all due respect, the 7(a) start-up volume is up 6.3 percent in numbers and 38.8 percent in dollars in 2011 year-to-date versus 2010 year-to-date. There is 29 percent of the number of loans to start-ups which is defined as businesses open for two years or less. There were 10,474 loans made to start-ups so far this year versus 9,856 last year. And the start-up dollars are 3.255 billion year-to-date versus 2.346 billion last year.

Ms. VELÁZQUEZ. It is up higher from SBA.

Ms. OZER. But the information—the thing that I have seen just in my bank is there has been a lot of start-ups because there are a lot of people out of work.

Ms. VELÁZQUEZ. And I bring you back——

Ms. OZER. And some of these people that are out of work actually do have money as a start-up to start their businesses because they have either been laid off with a package or they are older, more successful people that have lost their jobs and they can do capitalization. So we are doing them. And as far as the small loans falling off, a lot of people are using the SBA express loans less but they are using the larger loans more. But we need those larger loans because as companies grow, like Mr. Hall is saying, people that have five and six, they need—they get above the two million. They have to renovate their stores. They need five million. So in my shop, we make loans the whole gamut.

Chairman GRAVES. I want to go back to my original question and that is I am talking about people who are doing start-ups that do not have the equity out there for the personal guarantee.

I would be very interested in hearing what you have to say, Mr. Kottler, about that. Or what can we do? What can be done to help those individuals out? I mean, we hear a lot about those people that have that money or have something to back them up. But I am talking about those people that do not. What can we do in your experience? Or what can be done in your experience?

Mr. KOTTLER. You know, I think it is an ongoing process, so I do not think there is one silver bullet that gets it. I think it is a combination of them finding personal funds or friends and family to get started. Coming into the bank and working on business plans and beginning a discussion. I think one of the most interesting things to me is that customers who come in and have discussions about what they are thinking about with their banker and get to know them long before they actually come in for the loan request have—that helps a lot. And I think then just making sure that we have programs with SCORE and SPDCs to help out.

In a bank that I worked for in the past, we actually worked with the Kauffman Foundation to do first-time business owner training, somewhat similar to some of the first buyer homeowner training. And that was very successful. The people that graduated from those programs were more successful in their business than other start ups. So I think there are a whole bunch of different things that we just need to put together to make it work as opposed to one big thing.

Chairman GRAVES. Dr. Jacobe, do you have anything to add?

Dr. JACOBE. Well, we have done some surveys asking small business owners from their experience starting what did they do right and what did they do wrong. One of the things they highlighted was not starting with enough capital. They tried to get in and they did not have enough capital to make it. And I think in this environment, some availability of at least some kind of minimum level of capital is even more necessary because they are not going to have immediate success. And so you do not want a lot of people going out there and trying in this environment without some kind of capital foundation.

Chairman GRAVES. Who is next?

Mr. OWENS. Thank you, Mr. Chairman.

Ms. Ozer, you testified before that the issue is really a demand issue or a top-line issue. So for businesses, they do not have adequate demand really to support a pro forma that allows them to come to a bank and secure a loan and that that is inhibiting their ability from a financial perspective to come in and be successful in the loan process because they need to grow the top line in order to be successful to have the ability to repay the loan. Is that a fair summary of where you think many businesses are at?

Ms. OZER. Yes. I am not sure that we are communicating on the same–I am saying that existing businesses right now, not start-ups.

Mr. OWENS. Right. Correct.

Ms. OZER. I am not talking about pro formas. I am saying that what we are seeing is that the bottom line is profitable but some of them have been experiencing downward trends in the top line so that in order for us to make a loan, we need to see year-to-year that either the bleeding has stopped and they can still pay or that it is, you know, back to increasing again.

Mr. OWENS. Okay, but that obviously puts them in a position where there is not as much demand for bank loans. If they are not having growth in the top line, they clearly do not need a line of credit, for instance, or to increase their line of credit because they are not buying additional raw materials or additional product for resale.

Ms. OZER. Well, they are still funding their receivables and sometimes they need to have short-term capital so that they can fund their daily activities. If they are not a cash business, even the level of business that they are doing, they still need short-term credit lines in order to operate on their regular cash cycle.

Mr. OWENS. But they are not increasing the level of their borrowing, I am assuming.

Ms. OZER. Well, it all depends. I mean, a lot of them have, you know, they still need to maintain it. And some of those businesses——

Mr. OWENS. I did not say maintain. I said increase. They are not increasing their borrowing because they do not have additional sales or additional product that they are purchasing.

Ms. OZER. But they need to grow.

Mr. OWENS. Mr. Kottler, Mr. Hall, do you want to comment on that?

Mr. HALL. Yes, sir. Let me just put it in a Dairy Queen perspective. Five Dairy Queens. And my sales are not going up dramatically, but I am about to have to borrow money to renovate those facilities to maintain my existing business or else—you can be in business and not keep up with the competition and you are just slowly going out of business. So I would not—I would say to you, certainly in my personal case I am going to borrow money without the expectation of greater sales. I hope I get them and I hope I am able to get a higher bottom line, but at the end of the day I am probably going to have a lesser bottom line but I am still going to be in business. And I think there is a lot of that going on that maybe does not make much sense to you but if you think about it I have got my base. And if my base goes away, then where do I get my money? So I am willing to accept less profit to grow, but what I am also doing is growing jobs, keeping people employed, and keeping my system in place.

Mr. OWENS. Would it be fair to characterize what you are doing as more in the form of a capital loan as opposed to a working capital loan?

Mr. HALL. Well, in my business it is just I have to make enough to make payroll. And so when I have to borrow that money to do the construction, certainly, that would be a capital loan. But I am telling you, in a business environment right now the margins are so thin that you just literally—there is no big cushion. We do not have a big pile of money sitting in a bank waiting. We are going, figuring out how to get where we need to be.

But I just wanted to respond to your point about the idea of there will be a situation. You cannot always look at this and say I am going to get this much return, certainly in a small business environment. Because partly it is about the family. Partly it is about keeping these people employed and keeping our business going.

Mr. OWENS. And obviously, some of this would be cured by increased sales.

Mr. HALL. That would be right. Love to have it. Love to have it. More Blizzards is good for me.

Mr. OWENS. I also want to go back to something that Mr. Jacobe said before and that was you focused on housing. If we solve the housing problem that that would do a number of beneficial things, including presumably increasing available collateral for loans. What is the solution there? I am curious as to the bankers we have on the panel. Do they have a substantial amount of foreclosed properties that they are holding on their balance sheets or is that not an issue for your banks?

Mr. KOTTLER. For my bank it is not but certainly for a number of our member banks who are some of the largest banks in the country, they certainly have been working through those issues. But I think from the standpoint of housing value, we talk about start-ups and other kinds of small businesses. And once a borrower gets beyond personal credit cards and personal savings, the place that they oftentimes go to next is to pledge their house.

Mr. OWENS. Right.

Mr. KOTTLER. Either as a personal loan or a business loan to fund their business. And so as home equity values have gone down, especially in certain parts of the country more than others, it has taken away that source of collateral which has made it more difficult.

Mr. OWENS. Mr. Jacobe, what is the solution?

Dr. JACOBE. Well, I wish I knew. The real solution is to get a bottom in housing and a bottom in values so that everybody can start improving from that point on. And you know, the danger now, if you have seen the latest reports, is that everybody is fearing the double-dip in housing, another step down. And that has the same kind of repercussion throughout the economy.

You know, I think that traditionally Americans have valued homeownership. Some people seem to be moving away from that but I think the nation needs to value homeownership and do whatever it can to stabilize housing and get people buying again in a secure environment. If you are going out to buy a house today, leverage works reverse, works against you. And so if the price of the house you are going to buy goes down by five percent, you can lose your downpayment. The point is you have got to stabilize that to get things going. And I think people underestimate how important housing is to the future of the economy.

Mr. OWENS. Thank you. And I yield back.

Chairman GRAVES. Mr. Coffman.

Mr. COFFMAN. Thank you, Mr. Chairman.

There has been discussion about some of the banking regulators, and in my community some of the smaller community banks were particularly hard hit and their concern was that they felt that there was an overreaction to some degree, that they were paying for the sins of the big banks during the financial crisis. For example, their capital reserve had a 20 percent increase early on in this crisis. And their market niche seemed to be commercial real estate, which was particularly hard hit. I wonder if you could comment in terms of small business access to capital related to community banks. In your view, was there an overreaction by the regulators? Anybody.

Ms. OZER. Well, we are a little bit larger than a community bank having $14 billion in assets, but our commercial real estate division was the most hard hit in our bank. So as far as an overreaction is concerned, the perception is that the amount of capital that you have on reserve now is going to be looked at. If they say it is best to be at 10 percent, then you really need to have 13 percent or 15 percent. So as such, I do not think that they have over—well, are you saying the regulators overreacted?

Mr. COFFMAN. Regulators to the community banks.

Ms. OZER. I do not know the answer to that. I just do not know if they overreacted, but they reacted appropriately in some cases.

Mr. COFFMAN. From a borrower perspective, you know, most of the borrowers I know think there was an overreaction, especially at the smaller bank level because that was the most given response as to why they could not get the same credit that they had had in the past. You know, we are facing increased regulation and that—so from a borrower's perspective there certainly is a perception out there. And, you know, just as a general comment, I mean, and the regulators, in good times it seems to me they ought to be a little more conservative and trying to get you to put stuff back. And then in bad times it seems like they ought to be trying to help the good borrowers get through the tough times. Because we are talking about people that have had a long history of performance and because of really something they really did not have much control over, are having to struggle.

Now, unfortunately, I think the community banks are in exactly the same position. So that again gets back to the RFA program where we are trying to match these two people. We kind of both have been in the same position. See if we cannot get together and get some supply meeting the demand situation.

I have had a number of community bankers inform me that even if they had performing loans in commercial real estate, that those loans were downgraded. And they should have been just, you know, a watch put on them but not downgraded. That would cause them to pull money available for lending into their capital reserve. Anybody else comment on this?

Just one last related question and that is in terms of job creation, which is the subject of today's conference, access to capital is very important. But what in your—the majority—I was a small business owner. I had a corporation. And the majority of small businesses are structured as corporations. In terms of job creation what would be the impact of increasing the income tax rate on job creation knowing that corporations, essentially that is the tax rate that you pay? Would anybody like to comment on that? Please.

Mr. HALL. I am a sucker. I am a sucker for this.

You know, as a small business owner, you know, as you know, as you have already articulated, most of the money flows through from our businesses to our personal income tax return. And I do not—you know, there is nobody going to tell you we want more taxes. I will tell you right now though, I am not afraid to pay what is fair and what needs to be paid. But on the other hand, you know, we have been hit with the alternative minimum tax, as a lot of people have been hit by that over a period of time as it just creeped up. People that their business income is flowing through to their personal tax return and they are not getting any deductions and it is difficult. I know it sounds like a lot of money but I am telling you in today's environment, if you are trying to survive and capitalize your business out of your personal situation, which is what all small businesses people do, there are some issues as a taxpayer. I do not want to have to pay more taxes. I am willing to pay my fair share and I want to pay my fair share, but I also have to survive.

And I will tell you, if you start taxing, and unfortunately, I am afraid the situation with health care, you are going to lose jobs. You do not realize it but you are. In the real world you are going to lose jobs. It has to happen because there is no other—we are squeezed so tight right now that there is no place for it to go.

Mr. COFFMAN. Thank you, Mr. Chairman. I yield back.

Chairman GRAVES. Ms. Clarke.

Ms. CLARKE. Thank you very much, Mr. Chairman. Thank you, Ranking Member Velázquez. And I would like to thank our panel for their insightful testimony today.

We all understand only when all of our nation's small businesses are active participants in a robust recovery that adds jobs will our nation fully recover from the recent economic downturn. I also understand that allowing the regulatory environment to return to one that allowed for the financial collapse in the first place is irresponsible at best.

Today's testimony, especially that of Mr. Jacobe and Mr. Kottler, illustrate the difficult task facing our nation with the lack of consumer spending highlighted as the top concern of small businesses—excuse me, small business owners—with regards to hiring. This fact itself feeds back into the anemic consumer spending. The fact that private lenders are not lending even to those who would otherwise be deemed creditworthy has led to the issue that Ms. Ozer pointed out regarding the 7(a) program approaching its ceiling later this year.

So my question is this. Given that there is a need and also recognizing that returning to lax regulatory environment that caused our current problem would be unwise, what else is needed to incentivize private lenders to free up the capital that would allow small businesses to expand and hire, which in turn would turn around the weak consumer spending and get our economy back on track?

Dr. JACOBE. That is a really tough question. I think there are a lot of things that could be done that would encourage local lenders to hold more loans. Everybody who has tried to figure that out has had some difficulty in terms of how to do that effectively. And you have tried with various kinds of programs. You know, the big thing is to try to get consumers spending again. And that is a larger issue. Once that happens, then everything turns positive. If in the interim you can figure out a way to get lenders to hold more loans themselves instead of the government programs but get more loans in some kind of incentive way, that would help also.

Ms. CLARKE. Yes, Ms. Ozer.

Ms. OZER. I think that, you know, utilizing the government programs is helping us to do that but even at that level I agree with Mr. Jacobe in the fact that the consumer confidence and the consumer spending is all hand-in-hand and that is all tied up with more jobs, more disposable income, and so forth. So if we can continue to try to get the money out there to businesses that hire people, then the outlook will go on. But it is a very difficult situation. And I tend to agree with him that until the home level, the values in their homes come back and they have confidence that they are not going to lose their homes, that is their priority, is where they live and that they have jobs and money to put on the table, when that comes back. I think that the banks are doing everything they can with the tools that they have to get money out there to small businesses. I know that in our bank, you know, someone else asked about the foreclosure rate. If the people are paying on the loans, we are working with them and not foreclosing even though they have been downgraded because the regulators are forcing us to downgrade because the LTVs are not there. But if the loans are being paid, they are still in the bank. So, you know, the banks are trying to work with the people that they have lent money to to keep the businesses going, to keep people employed, to keep people spending money. It is just a cycle.

Ms. CLARKE. Okay. Mr. Kottler, did you want to—you are at Capital One. You have got to have the answer. What is in your wallet?

Mr. KOTTLER. I am not there anymore. But you know, it is interesting when you watch borrowers. So in a robust economy you see borrowers coming in and they want working capital lines of credit to hire new people to fund new contracts. They want to purchase new equipment which then leads to more people to run that equipment to more jobs. Coming out of the bottom of this recession what we saw was we started to see loan demand go up but it was for things like I want to buy the building that I am in because I have been leasing it and now it is worthless and I can get a good deal on it. I want to, you know, I want to buy my competitor who is weakened and I can do that. And those things—those kind of loan requests do not necessarily create jobs. So as we get more consumer spending and we get more economic growth, then we will start to see those kind of loans from established businesses be the kind of loans that say we are willing to commit and expand. And that is not—we have seen less of that up to this point.

Ms. CLARKE. Do you want to add anything at all, sir? Yes.

Mr. HALL. No, ma'am.

Ms. CLARKE. Okay. Well, I yield back the balance of my time. Thank you again.

Chairman GRAVES. I want to thank all of you for participating today. And this Committee is about job creation and helping small businesses. And we are going to do everything we can to try to make sure we do what we can to provide access to capital for those small businesses, particularly the ranking member and I are very committed to helping those start-ups as best we can.

But again, I want to thank all of you for being here, and I would ask unanimous consent that all members have five legislative days to submit statements and supporting materials for the record. Without objection, it is so ordered. And with that, the hearing is adjourned. Thank you all very much for coming in.

[Whereupon, at 2:46 p.m., the committee was adjourned.]

CERTIFICATE OF NOTARY PUBLIC

DISTRICT OF COLUMBIA

I, Stephen K. Garland, notary public in and for the District of Columbia, do hereby certify that the foregoing PROCEEDING was duly recorded and thereafter reduced to print under my direction; that the witnesses were sworn to tell the truth under penalty of perjury; that said transcript is a true record of the testimony given by witnesses; that I am neither counsel for, related to, nor employed by any of the parties to the action in which this proceeding was called; and, furthermore, that I am not a relative or employee of any attorney or counsel employed by the parties hereto, nor financially or otherwise interested in the outcome of this action.

Notary Public, in and for the District of Columbia
My Commission Expires: May 31, 2014

Statement of
Chairman Scott Tipton
Subcommittee on Agriculture, Energy and Trade
On Wednesday, June 1, 2011
Before the House Small Business Committee hearing on Access to Capital: Can Small Businesses Access the Credit Necessary to Grow and Create Jobs?

Thank you Chairman Graves and Ranking Member Velázquez for convening today's hearing. I would like to join my colleagues in welcoming our panelists as we continue to identify ways for small business to gain access to capital so they can grow and create jobs.

Small businesses are the backbone of the U.S. economy, accounting for about half of the country's private sector workforce, and responsible for creating close to 7 out of every 10 new jobs. Access to capital has been a hot topic amongst small business owners and constituents in my district. Many continue to struggle in our current economy and a constant source of their hardship is the inability to access capital to grow their businesses and create jobs.

Last month I was proud to join Congressman Perlmutter and Congressman Coffman in introducing a bipartisan bill called The Capital Access for Main Street (CAMS) Act. This legislation seeks to free up much needed capital, by allowing small banks with under $10 billion in assets to amortize a portion of their commercial real estate loans over a seven-year period. As a result, these small banks will be able to provide more capital to growing small businesses. . Small businesses can then use this badly-needed capital to expand and create jobs.

Many of the small business owners I know are some of the most hardworking and proud citizens in America. They labor long hours, are loyal to their employees, and have an urgency to pay back their loans and grow their businesses. However, if they can't get these responsible loans in the first place, then small businesses, as well as the rest of our economy, will continue to suffer.

Again, Chairman Graves, thank you for holding today's hearing. I do have a few subsequent questions at this time.

IFA International Franchise Association

Franchising Building local businesses, one opportunity at a time.

SMALL BUSINESS CREDIT ACCESS REPORT

How lenders and franchising can **accelerate** the economic recovery

IFA Pres. & CEO Steve Caldeira announces a broad educational campaign in partnership with lenders to expand credit and develop lending programs targeted to franchise businesses.

Getting America Lending Again – To Franchising

As the nation pursues economic recovery, the IFA wants to get America lending again -- to franchising. This structured, scalable small business model has often led economic recoveries in the past, but franchising depends on adequate credit flow to be a locomotive for job creation. IFA research shows credit flow will fall short by 20 percent in 2011 -- holding back the recovery and the job creation America urgently needs.

Campaign for Credit Access Takes Flight

To reach this maximum growth potential, the IFA announced an expanded Credit Access Campaign to unleash credit flow from lenders. To galvanize support for the campaign, the IFA hosted a Small Business Lending Summit in conjunction with the Consumer Bankers Association (CBA), CIT Group, the National Association of Government Guaranteed Lenders (NAGGL) and the National Restaurant Association (NRA).

"Franchise businesses can accelerate job creation faster than other businesses. As evidenced by the industry's 40 percent economic output growth rate over the past decade, if given adequate financing and a strong pro-growth legislative and regulatory environment," said IFA President & CEO Steve Caldeira, CFE. "Due to its structured, scalable and proven business model, we believe franchising offers exactly what lenders are looking for- a lower risk way to generate revenue in a still uneven economic recovery."

> "The franchising industry's proven, structured, and scalable business model translates into more profit and less risk than other investment opportunities for lenders."
>
> –IFA President & CEO Steve Caldeira, CFE

"There is a direct correlation between small business access to credit and job creation," said Tony Wilkinson, CEO of NAGGL at the summit. A NAGGL event in Atlanta brought leaders in franchising together with some of the top small businesses lenders in America as part of the campaign (see sidebar).

(continued on page 4)

CREDIT ACCESS CAMPAIGN HITS ATLANTA

As part of IFA's Credit Access Campaign, franchise industry leaders addressed the nation's top small business lenders during the National Association of Government Guaranteed Lenders SBA Technical Conference in Atlanta.

Richard Bradshaw, senior vice president and head of SBA lending at TD Bank, the fourth-largest deposit bank in North America with over 2,000 branches, said he welcomed IFA's involvement and approach to engaging directly with small business lenders through NAGGL.

"The tie-in with IFA was excellent, especially talking with some of the IFA members," said Bradshaw. "The networking makes that next call so much easier. I'm very excited about some of the introductions and will be following up."

"These new relationships not only enhance communication with key groups in the lending community, but speak to the value franchise businesses will receive through the IFA," said Karen Spencer, CEO of Fran-Systems, sponsor of the Credit Access Campaign's new video.

"The thing that I like about the franchise business is that because of the FDD [financial disclosure document] you get so much information," said Bradshaw. "I'm not sure the banks realize that. Because of the FDD you have a ton of information as to how that store should perform."

From left: IFA Credit Access Committee Chairman and IFA Board Member William G. Hall (William G. Hall & Company, CEO International Dairy Queen Multi-Unit Franchisee) and National Association of Government Guaranteed Lenders Pres. & CEO Tony Wilkinson.

IFA Franchising

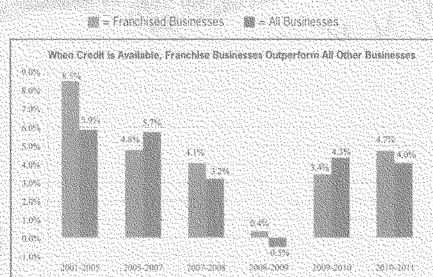
Building local businesses one opportunity at a time

SMALL BUSINESS CREDIT ACCESS REPORT

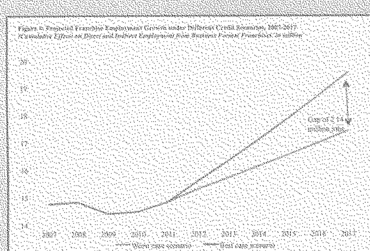
Fortune magazine's Sr. Editor-at-Large Geoff Colvin moderates a panel at IFA's lending summit. Lenders encouraged franchises to educate banks about the value of the franchise model. Among the recommendations – performance measures that show the model is scalable and affords lower risk and greater return on investment.

Senate Small Business and Entrepreneurship Committee Chairman Mary Landrieu noted the major force franchising plays in the economy and the importance of solving the $2 billion lending gap impacting franchise businesses.

IFA estimates that banks in 2011 will lend about **$8.4 billion** to franchisees–a **20% shortfall** compared with projected **demand of $10.4 billion**. The $2 billion shortfall will result in a **loss of nearly 8,000 unit transactions**, both new and transfers, and a loss of more than 82,000 jobs and **$10.7 billion in annual economic output.**



Source: *Linking Franchise Success with Economic Growth and Net Job Creation* (an IFA White Paper)



Franchising could help close the job gap in the nation's recovery. With adequate credit access, franchising could add over 2 million jobs by 2017.

Source: *Linking Franchise Success with Economic Growth and Net Job Creation* (an IFA White Paper)

IFA
INTERNATIONAL FRANCHISE ASSOCIATION
Franchising
Building small businesses, one opportunity at a time.

SMALL BUSINESS CREDIT ACCESS REPORT

THE WALL STREET JOURNAL.

Looser Lending Leads to New Jobs and Economic Growth

Each new franchise creates an average of 10 direct jobs. Every time a new fast-food franchise opens, an average of 20 people get jobs; every new lube shop means six more people are employed.

Mr. Caldeira and the IFA are on a mission to inform lenders about the advantages of franchising and to convince them to open up the credit spigots even wider.

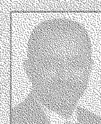
Closing that $2 billion lending gap was a major focus of a Small Business Lending Summit in April, organized by the IFA to open a dialogue between the franchising and lending communities. "Banks have money to lend," says summit attendee Mary Navarro, vice president of retail and business banking for Huntington Bank in Columbus, Ohio, and a board member of the Consumer Bankers Association (CBA) trade group in Arlington, Va. "But franchisees don't necessarily get those loans because they don't know how to approach banks. We want to know about the franchise itself: how long it's been in business and how successful other franchisees have been."

Another problem, says summit panelist Aziz Hashim, a multiunit franchisee from Decatur, Ga., is that banks don't want to take a chance on a franchisee until after he or she is successful. Although he had a college degree and had worked part time in fast-food restaurants for eight years, Mr. Hashim says he could borrow only 50% of the cost of his first franchise, a KFC he opened in downtown Atlanta in 1996. "My parents mortgaged their home and gave me their entire life savings to finance the rest," he says. Now that he operates 54 Checkers, Popeyes and Domino's Pizza franchises, borrowing money is much easier.

–Julie Bennett

What's holding back lending?

- New reserve requirements for banks
- Heightened regulatory scrutiny
- Reduced home equity values
- Risk aversion
- Lack of know-how by borrowers



How I Got My First Loan in Franchising

By Aziz Hashim

I graduated from the University of California at Irvine with an engineering degree. I was recruited by IT firms and got hired by a big company. My family was thrilled. But within a few weeks I knew the job and sitting in a cubicle just weren't right for me. It didn't hold my interest. I missed the pace and excitement of the restaurant industry, which was where I worked through high school and college. I had worked in a Burger King. The pace excited me.

Because of my restaurant experience I was able to get approved as a franchisee to open a KFC. But I still had to get financing, which wasn't easy because banks were not doing loans without real estate collateral. Luckily, I had a friend on the board of Summit Bank. Still, the bank normally didn't do a lot of restaurant loans. My friend sent me to an SBA loan officer named Cheryl Beer. Apparently Cheryl and my friend had to work with the board to get the loan approved. Finally they did. I had to put 50% down, but I got the loan. I started my franchise and created 20 jobs right away in downtown Atlanta. Then I opened a Subway.

I really loved what I was doing. Two years later my Mom moved to Atlanta from California. She had a career in the banking industry, but I encouraged her to try her hand at running a Subway. She applied and she was approved to be a franchisee. For the financing, I said, "You need to go see Cheryl." My loans were performing well so it was easier for my Mom, and we didn't need to go through the SBA process.

About four years later in 2002, my sister, a rising star in corporate America, got caught in the dot-com bust. Her company was scaling back. My Mom and I encouraged her to try franchising as well. Of course, we sent her to Cheryl. By that time, I had about 15 restaurants.

Today, I own 54 restaurants and four retail stores, employing over 1,200 people. I love people and I try to help them succeed. I have an attorney, finance, real estate and a full accounting department as well as top-notch managers on my team. We create jobs. We like to do that. It makes me proud to help others and help our economy. It's the American Dream and my family has benefited, too. It is all because of franchising, and a great country. And it all started with an SBA loan.

Aziz Hashim is President & CEO of National Restaurant Development (Multi-Unit Franchisee of Popeyes, Checkers/Rally's Drive-In Restaurants, Subway and Moe's Southwest Grill)

SMALL BUSINESS CREDIT ACCESS REPORT

IFA

Franchising
Building local businesses, one opportunity at a time.

IFA's Credit Access Education and Advocacy Toolkit

Educate the Franchise and Lending Communities About the Unique Advantages of Franchise Lending

- Regional education and networking events
- "Discovery Days" for lenders to learn more about franchise brands
- Webinars including best practices to help franchisors and franchisees better prepare to get loans

Provide Technical Assistance for Borrowers & Lenders

- IFA Toolkit to create bank-ready borrowers, "Franchising 101 for Lenders"
- Data demonstrating the benefits to lenders of lower-risk franchise lending
- Web-based Franchise Lending Resource Hub to train and connect lenders and borrowers
- Standardized loan profile to provide the information lenders want to see when evaluating a franchise loan applicant

Advocate for Legislative and Regulatory Changes to Improve Franchise Credit Access

- Jointly advocate for pro-business, pro-lending policies
- Ensure SBA guaranteed loan programs have adequate resources
- Educate regulators regarding the job-killing impact of credit flow stoppage

(continued from page 1)

New Tools to Spur Lending, Job Creation in Franchising

The Credit Access Campaign includes educational, technical assistance and policy initiatives with partner organizations. IFA leaders will speak at franchise and lending-related events throughout the country on the advantages of franchise lending, and to better educate and develop stronger relationships between franchisors, franchisees and lenders.

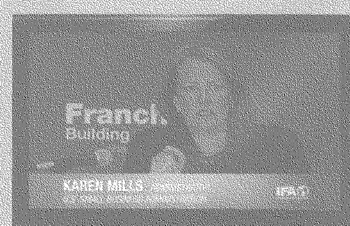
A Joint Working Group will also advocate for pro-business, pro-lending legislative and regulatory policies, including dialogue with the Federal Deposit Insurance Commission and with federal lawmakers.

The campaign will allow partners to collaborate on private-sector solutions that will enable long-term job creation and economic growth as part of a Credit Access Toolkit (see chart above). IFA-supported "Discovery Days" will aid lenders in learning more about franchise brands and the wide-spread support they offer to franchisees to enable their ongoing success.

There are over 825,000 franchise businesses across 300 different industries creating nearly 18 million jobs and generating over $2.1 trillion to the U.S. economy, according to data prepared for the IFA by PwC. Yet a 20 percent lending shortfall to franchise businesses in 2011 is significantly impacting the ability of franchising to create jobs, according to the latest IFA Small Business Lending Matrix & Analysis.

Find out more at www.franchise.org

Check out IFA's Credit Access Campaign on YouTube



"There are still gaps in lending," said SBA Administrator Mills, in IFA's exclusive video of the Small Business Lending Summit.

IFA expresses its gratitude to the following anchor partners:

IFA Franchising — CBA Consumer Bankers Association — CIT — National Association of Government Guaranteed Lenders — National Restaurant Association

CUNA
Credit Union National Association
601 Pennsylvania Ave., NW | South Building, Suite 600 | Washington, DC 20004-2601 | PHONE: 202-508-6745 | FAX: 202-638-3389
cuna.org
BILL CHENEY
President & CEO

June 1, 2011

The Honorable Sam Graves
Chairman
Committee on Small Business
United States House of Representatives
Washington, DC 20515

The Honorable Nydia Velazquez
Ranking Member
Committee on Small Business
United States House of Representatives
Washington, DC 20515

Dear Chairman Graves and Ranking Member Velazquez:

On behalf of America's credit unions, thank you for holding today's hearing entitled "Access to Capital: Can Small Businesses Access the Credit Necessary to Grow and Create Jobs?" CUNA represents nearly 90% of America's 7,500 state and federally chartered credit unions and their 93 million members.

Credit unions stand ready to help businesses grow and create jobs. Since their founding in the United States over 100 years ago, credit unions have been serving the credit needs of their small business-owning members. While small business lending does not make up the largest portion of credit union lending, it is the fastest growing segment by a significant margin. In fact, as banks have reduced credit availability to small businesses over the last several years, credit union business lending has expanded. Furthermore, credit unions have proven the ability to do small business lending safely and soundly, demonstrating remarkably lower charge-off and delinquency rates than banks making business loans. However, since 1998, credit unions have been subject to a statutory business lending cap of 12.25% of their assets. Today, many credit unions are rapidly approaching the cap while others choose not to engage in business lending because of the cap.

Representatives Ed Royce and Carolyn McCarthy have introduced legislation (H.R. 1418) to raise the business lending cap to 27.5% of total assets. The administration supports this legislation and worked with National Credit Union Administration to shape it. We conservatively estimate that if H.R. 1418 were to become law, credit unions could lend an additional $13 billion to small businesses in the first year after implementation, helping them to create nearly 140,000 new jobs.

Unlike the recently enacted Small Business Lending Fund Act, which gave community banks $30 billion of taxpayer money as an incentive to lend to small businesses, increasing the credit union business lending cap could be done without

AMERICA'S CREDIT UNIONS
PO Box 431 | Madison, WI 53701-0431 | 5710 Mineral Point Road | Madison, WI 53705-4454 | PHONE: 608-231-4000

The Honorable Sam Graves
The Honorable Nydia Velazquez
June 1, 2011
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spending a dime of taxpayer money and without increasing the size of government. To be clear, credit unions do not need taxpayer money to lend more to small businesses; they need the authority from Congress to do so.

America's credit unions and their 93 million members stand ready to be part of the solution to the economic problems our nation faces. In an effort to promote economic recovery and job creation, we strongly urge Congress to increase the credit union member business lending cap. While we are aware that this legislation is not within the jurisdiction of this committee, we hope that the Committee will be supportive of this commonsense economic recovery and job creation measure that requires no taxpayer money and does not expand the size of government. We encourage all Representatives to cosponsor H.R. 1418, and hope the House will act quickly to provide a much needed infusion of capital for small businesses.

Best regards,

Bill Cheney
President & CEO

Associated Builders and Contractors, Inc.

June 1, 2011

Chairman Sam Graves
House Small Business Committee
United States House of Representatives
Washington, D.C. 20515

Dear Chairman Graves:

On behalf of Associated Builders and Contractors (ABC), a national association with 73 chapters representing more than 23,000 merit shop construction and construction-related firms with nearly two million employees, I am writing to thank you for holding today's full committee hearing, "Access to Capital: Can Small Business Access the Credit Necessary to Grow and Create Jobs?"

Access to capital continues to be a major concern within the construction industry, which has been severely impacted by the economic downturn. The national unemployment rate for the construction industry exceeds 17 percent, with a loss of nearly 1.9 million construction jobs since December 2007.

Many ABC members have viable, low risk projects and/or contracts that simply need funding in order for work to commence. Additionally, many ABC members rely on community banks for capital. However, community banks are facing the toughest regulatory environment in decades. Federal banking agencies are overregulating the community banking sector and thus, jeopardizing lending for qualified small businesses that have received loans in the past.

ABC urges Congress to immediately address the near freeze on lending for private sector construction projects. During this time of economic recovery, it is critical that construction firms have access to much-needed funds.

We thank you again for addressing this issue and look forward to working with to address this issue in the 112th Congress.

Sincerely,

Corinne M. Stevens
Senior Director, Legislative Affairs